# DETAIL OF SPECIFIC ACTIONS REQUIRED - PHASE I OF THE STRATEGIC PLAN

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## INTRODUCTION AND SUMMARY

### A1. Process and Systems Integration: Optimizing Systems And Organization to Maximize Service Delivery

*I. Basic Integrated Business Processes and Systems Concept*

The Strategic Plan proposes that the Federal Government align its trust management systems and organizational structure in order to allow it to better discharge its fiduciary obligations to American Indians and American Indian Tribes in a manner more consistent with the acceptable legal standards of modern trust practice. The new structure will optimize and promote the performance of business processes, the execution of its trust responsibility, and the delivery of services and products to American Indian trust beneficiaries. Because the execution of the trust activities and the delivery of services are primarily dependent upon the performance of its business processes (e.g., what it does as its business, and how it does its business), the most effective and efficient method to establish such an alignment would be to base its systems and its organizational structure on established policies and procedures long used in private sector trust management. The trust management business processes consist of three fundamental trust process groups involved in the delivery of federal trust services to Indian Tribes and individuals: trust resources management, trust funds management and land title and records management.

The operational philosophy is that the policies, procedures and regulations applicable to national bank trust departments should be used as the guides in developing policies and procedures for AITDA and the fiduciary services performed by the U.S. Government for American Indian beneficiaries.

**II. Rationale for a Private Sector-Based Strategic Approach**

*Background*

The Special Trustee's assessment is that the present policies, procedures and systems do not allow the BIA to:

1) properly account for and invest as well as maximize the return on the investment on all Trust moneys of individual Indians and Indian Tribes; and

2) prepare accurate and timely reports to account holders regarding collections, disbursements, investments, and return on investments related to their accounts.

In order to accomplish the two major points described above, the Secretary of the Interior and those agencies that have been delegated responsibilities in this area must have a trust accounting and management system similar to a private sector trust department system (discussed below) in place to fully accomplish these goals or objectives. The essence of the trust accounting system that is needed is that all assets of an individual Indian or Tribe will be reflected on a single coordinated system that will enable a trust report or statement to be prepared for each individual account holder reflecting all the assets owned, a value at cost and market, a projected income for the assets and an estimated yield or current return on the assets. A trust accounting system has at its core the ability to record financial and asset information, values, income and compute yields or rates of return. The core system can be complimented by assets specific systems or modules to account for special assets such as real property in its various forms including farm or grazing land, retail or commercial improved rental land or buildings, mineral leasing, oil and gas leasing, etc. The present systems and tools that are being utilized by the Department of the Interior, Bureau of Indian Affairs, and Office of Trust Funds Management are independent systems that do not operate on an integrated basis enabling information and data to pass between the systems, be verified, audited and ultimately produce the desired complete, accurate and timely reports to account holders regarding their assets and income.

*Private Sector Trust Department*

A typical trust accounting system would have as its central elements the recording of all assets for which the trustee has fiduciary responsibility. Assets come in broad categories, including cash and cash equivalent; financial assets (common stocks, preferred stocks, bonds, debentures, notes, etc.); real estate, mineral interest; intangible non financial assets, such as leases and partnerships (general and limited); tangible assets including jewelry, china, silver, furniture, precious metals such as gold and silver, coins, ingots, etc. Within the trust accounting system there will be various system subsets, or modules that will provide enhanced ability to record and manage the assets. These subsystems utilize assets specific information in providing financial transactions, trust statements, or consolidated statements for accounts or for the trust department as a whole. Included in such modules or subsets would be a securities module that would enable monthly, weekly or daily pricing of financial assets that are traded on a national exchange such as the New York Stock Exchange and the NASDAQ. Pricing services such as the Standard & Poors, Bloomburg, and Morningstar could be integrated into this securities subset or module. In a similar manner, systems pertaining to land and improvements on the land are also available and can be utilized where appropriate. An additional module frequently used by trust departments would be a common trust or pooled investment fund system to manage the investment, accounting and valuation for commingled investments.

At the heart of the trust system and organization is a trust accounting or operations unit or department. In order to enhance the integrity of the system, promote uniformity in recording and reporting of assets, and to establish an adequate audit trail, a centralized operations and financial recording activity is important. The trust operations area would include the following elements and activities:

1. All financial data input to the system, that is the initial description and recording of all assets including financial assets, land, and tangibles.

2. Assets relating to the particular characteristics of an asset; e.g., common stocks have a specific description or security identification number, generally pay dividends on a quarterly basis that are uniform or may include special dividends; bonds generally pay interest on a semi-annual basis; land may produce rental income, leasehold payments, oil and gas revenues, royalties, etc.

3. Reporting within the trust department and to its beneficiaries; the systems and the operations group provides reports in a number of different forms within the department and to the beneficiaries. Within the department there would exist statements of conditions or balance sheets reflecting in summary form all assets such as the cash for which the department is responsible, all of the financial assets, all

of the land, etc; and all the liabilities, essentially the interest of all the beneficiaries (account holders) by the type of accounts, e.g., estates, trusts, agencies, corporate trusts, etc.

A report to an individual beneficiary or account holder would include a trust statement displaying cash equivalents, financial investments (bonds, debentures, and common stocks); land, tangible assets, miscellaneous assets. Wherever available, the statement would also include the cost basis of each asset, the current market value, projected income, and a market yield on the respective assets wherever appropriate. Complimenting the trust statement could be a report or data providing investment performance comparisons, that is the current income and total return for this particular account for a given period. This may be supplemented with comparison to standard indices including the Standard & Poors 500, a commercial bond total return index such as the Merrill Lynch Intermediate Bond Index or the Lehman Brothers Intermediate or Long term Bond Index, etc.

1. Administrative Data - A wide range of administrative information relating to an account can also be produced by the system. This data frequently is produced in the form of administrative ticklers, i.e., notices or warnings that inform a trust administrator or management of events to come or action that is required to assist in the timely completion of such tasks. As an example, if an account is for a minor who will obtain majority and thus be entitled to a distribution of an account at a particular age, a 90-day notice ahead of that time can be provided by the system automatically. If the trust account is responsible for the payment of casualty insurance on improved real estate and the payment of real estate taxes, etc., these payments can be anticipated and advance notice provided so that these important tasks are completed on a timely basis without late penalty charges. In a similar manner, prospective termination of rental, grazing or leasing activities can be anticipated. Anticipated income reports can also be produced by the system to reflect the dividends, interest, rental, etc. payments due at a particular time to assist in ensuring that all payments are received.

2. Management Data - The typical trust system can provide a host of data and reports essential to the proper management and oversight of trust activities. These reports can include the workload or number of accounts assigned to an individual accounts administrator, can report on the receipt of new accounts and the termination of existing accounts, the existence of accounts in particular geographic or organizational locations.

3. Audit - The typical trust system will have an audit trail and the ability for an independent auditor to obtain reports, identify transactions, and the originator of the transactions. The auditors can determine whether there are controls and balances and verification processes in place that are consistent with operating policies and procedures and good trust management techniques.

## III. Discussion of the Action Elements of the Strategic Plan

### *A. Purchase & Upgrades of Hardware and Software*

Regarding the purchase and upgrade for end-user workstations, the outside contractor found the existing BIA facilities largely well equipped (or in the process of installation) with 486/586 technology. However, a significant number of new work stations will need to be purchased and present ones upgraded to bring the systems at both the tribal and BIA levels up to modern standards.

The communications networking requirements are based on a new architecture which supports the Trust Management System in the style of a private sector trust operation. The communications architecture is basically a point-to-point type service since most calls will be directed to the Central database in the form of data inquiry or deposit information from the agencies and Tribes. It has been structured to evolve into a client/server configuration at any location where the need becomes justifiable. Client/Server architecture, as it will be used in this proposed configuration, does not move any stored data or program responsibility down to the field server level. All files and processing will be the responsibility of the central office level software and hardware. Rationale for client/server facilities would be based on other areas of activity, but not for Trust Processing.

Preliminary analysis pegs the user workstation requirement for trust management and the trust-related functions of land management at over 1900 PC workstations including all stated requirements at DOI, OST, BIA and tribal staff in the field offices and locations, trust interfaces at the tribal offices and the LTRO and realty user community.

*B. Core Systems Development and Related Costs*

The original points presented in the Conceptual Strategic Plan and the Mathis Report have been expanded into a complete, fully integrated Trust Management and Reporting System. Also, for Title Plant, the observations of the independent contractor have found that the existing Land Record Information System (LRIS) application presently is serving the user community adequately, where properly used. The inadequacies of this system are more related to training and data than to the functionality of the application itself. While not an immediate priority, the LRIS system will need upgrading in the near term and provisions have been made in the Strategic Plan for this upgrade (See the LRIS-2 discussion below).

The Strategic Plan proposes the acquisition of a commercially available Trust Asset and Accounting Management System product adapted to fulfill all trust management activities, including investment, management and reporting requirements.

Commercial Trust Management Systems (CTMS) exist with modules that will integrate and perform the trust asset and accounting management and land lease management functions in a centralized location. This is an important enabler in achieving the Strategic Plan's objective of bringing the Trust Asset and Accounting Management System up to commercial standards. It also presents policies, procedures and systems that will allow the trustee to properly account for and invest all trust monies, and prepare accurate and timely reports to account holders.

The current Integrated Records Management System (IRMS) application is insufficient to create a trust management system at a level of commercial acceptability that would fulfill the U.S. Government’s fiduciary responsibility without a major, expensive, lengthy reconfiguration. IRMS is on an outmoded system and does not articulate easily with LRIS. Since several well-documented private sector trust management and accounting systems exist and are for sale, it is substantially more cost effective to buy rather than rewrite. Acquiring an existing commercially available trust management system will greatly reduce development costs and accelerate the implementation phase.

Given the requirement of trust management and the magnitude of the user community, the use *of "client server networks"* was not a recommendation of the outside contractor, is not a requirement and provides no real advantage. At some sites, such a facility is not practical. Instead, the Strategic Plan proposes that an effective communication network architecture support internodal linkages between the AITDA administration offices and field offices in Albuquerque, Agency Offices, tribal facilities, a new national archive center, and other systems interfaces. Also, implementation of this architecture will accelerate the process of establishing a working network environment.

*C. Other Core Elements*

A number of other key elements are essential to meeting the Strategic Plan's goals. These elements include: a disaster recovery plan, daily backup capabilities, training at all levels, appropriate legal and legislative changes, IIM and tribal file cleanup and probate and appraisal cleanup. These elements must also be performed or acquired if the Strategic Plan is to be effective.

*D. End-User Administration; General Support and Maintenance*

Under this configuration, end-user administration is kept to a minimum. The original Conceptual Strategic Plan allowed for OTFM Technical Staffing at all Area and Agency Offices. The final Strategic Plan eliminated the field requirement for that level of support and has instead funded a centralized Help Desk function. Local Technical Support now exists at the Area Offices and appears sufficient to cover true technical needs. A simple re-allocation of funds to permit travel allows the senior technical staff to support the field operations. Funds were also earmarked for training at all levels with the intent being to increase user performance and reduce end-user reliance upon the technical support staff, wherever possible.

*E. Data Conversion and Imaging*

Data conversion will be required to transfer to the new system information for processing. It was the outside contractor's judgment that this task has been understated in the Conceptual Strategic Plan from a budget point of view. Based upon the observations made during the field trips, a large number of manual files as well as a number of locally developed manual processes were observed- hence, there exists a major task in normalizing the data prior to loading it into any system. From the sites visited, LRIS appears to provide the functions required. A significant data clean-up task appears necessary but conversion to a new application is not justified at this time.

The need for imaging is obvious and is requested at most locations. The primary need is to record maps, land deed documents, and any other documentation related to land ownership for electronic reference and safe storage of the original and paper documents related to land ownership. Lease and other financial documentation must be recorded from origination to final disbursement to owners.

The process of data clean-up and data imaging, when addressed as a common task, should provide a more synergistic effort to complete statement of work requirements.

*F. Systems Integration and Implementation*

The systems integration and implementation factors will be largely covered with the commercial trust system software to be acquired. A full integration will be a prerequisite in the selection of the software product. End-user training, which was also identified as a high priority, will be incorporated as a part of the related cost of core application acquisition.

*G. Access by Tribes*

The education and training to be given to the tribal end-users will be extensive and will involve about 450 end-users. Monies will also be spent to integrate current hardware and software that the Tribes now use with the new system. Access to the information depository will be guaranteed so that the

Tribes can extract data and manipulate and customize the data for their own general business purposes.

*H. National Archives Center and System*

Internal studies and those of the outside contractor revealed the almost total lack of back-up and archiving procedures. One site of all those visited had addressed the archival issue. The equipment required was purchased with tribal funds and installed in the Field Office. The staff was trained in the procedures related to imaging and verification, which was supplemented with the orientation required to use the services and functions of the system. This site could be the base for a model of what has to be done and one operational solution for consideration. A key lesson learned was the magnitude of set up time required. After one month of attempting to do the task with staff members, it was found to be more prudent to out source, saving both time and manpower.

The Strategic Plan budget contains the estimated costs for 1) equipment costs for imaging, 2) equipment costs for storing the data, 3) equipment costs for integrating this into the network for access by all concerned parties and 4) the out source expenses to avoid the labor intensive task and accelerate the process of imaging and creating document control.

*I. Upgrades to General Ledger System*

The commercial trust management system, as defined above, includes the trust accounting functions and the changes required for the upgrade of the general ledge system.

*J. Additional Budget Items*

1) Personnel Training

Across all area, agency and tribal sites a need for technology training, management training and organization development training exists at a significant level. These training needs create a major barrier to effective and efficient office operations having to do with the implementation of current fiduciary responsibility. It will be further compounded with implementation of a new integrated trust management system. Recent reductions in force have exacerbated these problems since field observations reveal that significant numbers of BIA and OTFM personnel are being required to perform a variety of different and new tasking functions. This has created significant confusion with regard to areas of responsibility, inadequate supervision, and negative feelings in both organizations. Without training and proper supervision, much of this additional duty is being accomplished with heavy doses of self-developed on the job training. In addition to these training needs, further work on process and procedure identification needs to occur. The field data supports the addition of significant increases in expenditures in training regarding the above. If this is approved and effected, there is a strong likelihood that the implementation of the trust system will occur without having to increase staff but rather through re-deployment and retraining. In short, a comprehensive skill mix transition plan is necessary coupled with an intense on-going training to provide the low-cost high performance trust operation which is the desired outcome of the strategic investment. Field data also support the Tribal long term interest in creating a system which allows for a larger role in managing their financial affairs. Therefore the ultimate system must have the flexibility to allow that transition and to provide the necessary training to accomplish the task.

2) Clean-Up Probate/Appraisal Backlog

This includes paralegal services and support services to reduce the probate backlog which averages about two years and is up to four years in some areas. This also includes certification of paralegal and appraisal resources.

**IV. Review and Analysis of Data in Land and Lease Management System and Associated Training**

Land Title and Records Offices provide a public record of the chain of title relating to real property allotted to and held in trust for individuals pursuant to various treaties with Indian Tribes and acts of Congress relating to individual Indians. The record keeping systems for LTROs include the Land Record Information System (LRIS) and Property Index. LRIS is an electronic information system and the Property Index is manually maintained.

Inputs are based on documents submitted by various authorities outside of LTRO for the purpose of being recorded against a property or properties. Most documents submitted for recording originate from an Agency Office or, in the case of compact agreements, Tribes. The guidelines for the types of documents to be recorded against a property are contained in 54 BL4,M supplement 9.

Outputs of an LTRO generally consist of a certified Title Status Report (TSR), a certified inventory of property held by a decedent, and uncertified indications of ownership by property or by individual.

While a given LTRO may only certify properties located within the boundaries of its Area Office, uncertified ownership information may be obtained across Area Office databases to provide an indication of ownership for an individual having trust property in multiple areas.

In comparison with public land record systems utilized under the jurisdiction of states, an LTRO combines the functions of a registrar of deeds and a title abstract company. However, the scope of an LTRO goes beyond these institutions in that an LTRO may give an opinion in the case of ownership disputes.

Ownership of land is also recorded by agencies on systems such as IRMS Ownership. A noted distinction of differences between the LTRO function and functions provided by systems such as IRMS Ownership is that the LTRO allows for public inspection of land title under certain circumstances while the IRMS Ownership information is subject to higher degrees of confidentiality.

A review of the Automated Land Management Records System (ALMRS) was performed by the Office of the Special Trustee and the outside contractor. Based on those reviews, it appears that the ALMRS is not a replacement for LRIS but, in fact, a complementary system and an effective source for official legal descriptions of the Indian properties and related data. ALMRS is still in the development stage. Specifics regarding an implementation schedule were not yet available. ALMRS provides no ownership information and therefore cannot be used as a substitute for LRIS, which, as stated above is a workable system for the present and near term. ALMRS has limited utility in replacing the basic IRMS system which is obsolete and must be replaced.

*Gaps in the LTRO Function*

A need for improved data flow between the LTRO and the mainframe in Albuquerque was articulated by interviewees of the outside contractor. Apparently the LRIS-2 project was to correct such deficiencies but was halted in the middle of the project.

Interviews indicated that guidelines for determination of whether a document should be recorded may not be applied uniformly. These guidelines are contained in a document referred to as "54 BIAM supplemental 9."

Theoretically, LRIS and IRMS Ownership records should agree as to ownership, subject only to a timing difference in a document being recorded by LRIS and posted by the Agency. In one case, LRIS reflected that an individual had an interest in only one property (tract) when the IRMS Ownership reflected that the same individual had an interest in more than 30 properties (tracts). This difference was not due to timing since the most recent document date on either system was 1992.

Field data suggest that the LTRO function is adequately supported with the current LRIS application. What is missing is sufficient training, and appraisal and probate backlogs are creating barriers to effective performance of the system. The existing appraisal and probate backlogs are exacerbated by a significant lack of qualified personnel to perform the tasks on a timely basis at all levels in the process chain. If these issues were properly addressed with additional human resources allocations, the LTRO organization could provide the information necessary to enable LRIS application to be fully effective. These findings are derived specifically from site visits to the Area Offices of Billings, Aberdeen and Anadarko. Software improvements to the LRIS system, while needed to improve the interoperability at the end-user level, should be a second priority after the re-engineering of the trust management system. Nevertheless, while not an immediate priority, the LRIS system will need upgrading in the near term. This is because each time ownership changes, the LTRO staff must perform time-consuming manual determination and documentation of ownership interests. LRIS, as designed, is not capable of performing automated chain-of-title calculations and it does not store chain-of-title or calculated ownership information. LRIS system improvements have been delayed for the past two years due to reduction in force and budget cuts. Provision for the upgrade of LRIS to LRIS-2 has been provided in the Strategic Plan over the medium term.

LTRO staff universally want more training on information systems. Some personnel are not sufficiently familiar with computers and lack on-site systems support, especially at agency and tribal locations. Some paralegal training would be helpful, especially related to probate functions. Other areas for training include real estate, accounting, property management, and appraisal, as well as a comprehensive overview of the trust process.

*Calculation of Fractional Interests*

A current system enhancement that would be beneficial would relate to the calculation of fractional interest for the heirs or beneficiaries of a deceased Indian. In the current environment, the LRIS system makes an automatic calculation of the new fractional share up to the 35 decimal places, if that is necessary. At the present time there is no such automatic calculation within the IRMS Ownership system. It is currently being done manually with some difficulty since most calculators will not go out that many decimal places. There is an impression that what staff members do is obtain the LRIS calculated fractional share and then enter that in the IRMS system. A system enhancement that would make the calculation process existing on LRIS available to the IRMS system would be desirable.

An additional suggestion was to consider the universal or global change order of interest in land and interest Indian property rights. In four current, separately-operated systems (IRMS Ownership, IIM, People and the Royalty Distribution Records System) the common identification of Indians is by their

ID numbers throughout the system. The universal change order that would provide for the one-time systems input of an ID number, would go a long way in avoiding some of the problems that are currently being encountered. The current procedure and validation controls, for ID number assignment are either insufficient or need tighter management. This requires further research for clarification.

Other field comments supported the regulation on special requirements to pay owners directly for oil and gas, and mineral interest, particularly 25 CFR 162.5 Section F. Others appear to favor some methodology and procedure that would require a proof of payment to the owner so as to avoid problems in determining whether owners have been receiving the correct amount of payment or payment at all. The rate of payment from the lessee is also an issue that arises in some of these problem areas. An additional concern is when an Indian actually uses land and he is a co-owner with other Indians or non-Indians. This may arise when property is inherited and four or five siblings have an undivided interest in the property represented by their fractional share. There are specific provisions in 25 CFR 162.2 as to the ability of a co-owner to use the land himself or herself. The problem arises when one of four or five siblings uses the land for grazing, farming, etc., but does not share the profits or rewards of such usage with the other siblings.

**V. Review of Special Interest Areas**

*A. Oil and Gas*

1) Ownership

For the purpose of this document, ownership refers to types of information and usage of information provided by systems such as MMS. Repositories for such information include IRMS, manual cards, IBM System 36 files, and PC data files which resemble IRMS file structures.

2) Appraisals

Appraisals for the purpose of conducting oil/gas leasing are conducted by BIA personnel with the support of the Bureau of Land Management and the U.S. Geological Survey.

3) Lease Procedures

Procedures for leasing trust property for oil/gas mining are documented by statutes and regulations. The more common leasing activity relates to property nominated for leasing by either a prospective lessee or by a beneficial owner of trust property. Leasing of such nominated property is conducted by public bid or auction.

A notable exception to the above procedure is the granting of concessions for the development of Osage minerals. The entity to whom the concession is granted becomes obligated to perform specific developmental activities in contrast to a normal lease which grants rights without obligations.

Procedures for leasing of "restricted fee" properties are governed by specific statutes and differ significantly from leasing of trust properties.

Administration of lease bonus and delay rental payments is handled at the Agency level.

a) Lease Administration

With the exception of Osage leases, lease administration is generally conducted at the agency level with the assistance of the Bureau of Land Management and in certain cases, the U.S. Geological Survey.

In the case of Osage leases, the Osage Agency staff includes skill levels, e.g. petroleum engineers, attributable to lease administration. Monthly lease production reports by operator are collected and reviewed by Agency staff. Historical production information is stored on an IBM System 36. Oil pricing is set by a prescribed formula.

b) Royalty Processing

Oil and gas royalty payments from leases for which the Secretary of the Interior has trust responsibility are processed through the Minerals Management Service and the Osage Agency. Royalty payments are deposited to Treasury when received with a deposit advice delivered to OTFM. Supporting data received from the purchaser is subsequently transmitted to the Royalty Distribution and Reporting System to be balanced and subsequently disbursed.

Payments from the Osage system are distributed through the Osage Annuity system.

c) Audit

MMS provides a series of validity checks against the purchaser report during initial processing. Additional reasonableness tests are made subsequent to initial processing with respect to price, volume and interest.

In addition to the collection of production reports by the Osage Agency, a field audit program is conducted in which BIA personnel gauge oil tanks on a routing basis.

*B. Forestry/Timber and Ranching/Grazing*

1) Ownership

Ownership refers to the land and the leases, contracts or permits depending on the asset under consideration identifies the appropriate ownership. Ownership is an impediment to good asset management only when there are multiple interests which require a consensus agreement for a lease, contract or permit to be let. Timber contracts typically span large acreages and hence encompass multiple owners. Sometimes this creates an impasse to good timber management; however, from the samples conducted by the Special Trustee and the outside contractor there were few occurrences of conflict.

2) Appraisals

Appraisals for appropriate fees to charge depends on the asset. For timber sales, the contract price appears to be based on open bidding. Grazing, on the other hand, is fixed at a less than market value, to cater to the Indian community. In some instances, grazing permits are only let to the Indian community and the "discounted rate" is by Bureau agreement.

3) Lease/Contract/Permit Procedure

The procedure for timber contracting as well as for grazing appears to be well defined and correctly followed. In the case of timber contracts, the process of obtaining a permit to sell is reasonably rigorous and must get Area approval before the contract is let. This approval requires that there has been a public notification, also, that clearance has been obtained by certain National agencies, i.e., National Historic Preservation and NEPA.

Also, once approval is granted, the buyer must advance funds to be held in escrow until the cuttings are certified (apparently, a monthly process or a periodicity relative to contract terms).

Grazing, on the other hand, is an agency approved process. The controls and compliance are performed by BIA personnel at the agency level.

4) Payment Processing

Timely and accurate payment processing is a major issue. Collections are performed by the local Agency BIA personnel and the checks which are received are then turned over to OTFM collection to process as per normal funds processing, but such payments are not always timely and are not necessarily traced back to an original lease to verify that the proper payment is being received or that delinquencies have been identified and dealt with. To the extent that collections process checks within the 24 hour window, funds then are applied to the trust accounts appropriately.

Gaps in Special Interest Areas

1) Oil and Gas

The basic element of information necessary for quality reporting of production information related to an individual trust account centers around property ownership. Ownership records at the trust account level are decentralized to the Agency level resulting in a variety of "trust accounting systems" as described above as IRMS, IBM System 36, "in house" PC-based and manual cards. Problems resulting from the lack of standard systems are manifest in centralized systems such as IIM and MMS.

Field issues were addressed regarding audit expectations relating to differences in bbls/mcf produced by a given well and bbls/mcf sold and reported to owners. Such concerns are not unique to DOI trust minerals; they permeate commercial trust management as well. The general rule governing the extent to which a commercial trust department audits the actual production at the well head level is dictated by the "prudent man rule," i.e., the degree of audit that a person with experience would use in the management of that persons own property. The resulting trust practice is guided by economic factors and the fact that collusion between the operator and a purchaser would normally be necessary to defraud the royalty owner. Consequently, field audits are normally conducted in cases where large amounts of production are involved.

A perception of substandard performance on the part of MMS was encountered. Interviews and direct observation were unable to produce supporting detail. It is possible that ownership and audit concerns previously discussed and their relationship to royalty distribution may be diverted to MMS, for the functions it is intended to perform, provides many audits and controls which are desirable. In addition, most funds are wired to MMS and deposited to Treasury, resulting in the generation of earnings for the trust beneficiary within a 24-hour time frame.

A requirement that 100 percent approval by owners of trust mineral interest on oil and gas leases was mentioned on multiple occasions as a source of problems and a hindrance of the opportunity to develop mineral interests. It was the opinion of those interviewed that the source of this requirement is judicial. An article written for the University of Tulsa Law Journal in the Fall of 1989 suggests that the judicial decision of a U.S. District Court in New Mexico was never published and that the case was later dismissed as moot. Thus, the Strategic Plan proposes that this problem be addressed by a policy change, rather than a legal change.

Formula pricing of Osage production has led to an interesting event. Rather than selling royalty interest pursuant to the formula, the Osage Tribal Council elects to "take in kind". In addition, it purchases the working interest share as a bonus above the formula and sells both the working and royalty production outside the formula at a price which produces an extra $400,000 annually to the Osage annuitants. This experience leads to policy questions regarding pricing which were not considered to be within the scope of this project.

The basic element of information necessary for quality reporting of oil & gas production information related to an individual trust account centers around property ownership, and this is where the system breaks down due to the problems of back-logs, deferred maintenance and training discussed above. Ownership records at the trust account level are decentralized to the agency level resulting in a variety of "trust accounting systems" such as IRMS, IBM System 36, "in-house" PC-based systems and manual cards. The CTMS integration with subsidiary support applications (e.g., LRIS) should eliminate the need for multi-systems.

*System Architecture*

A summary concept diagram of an integrated trust application and system architecture model would appear as represented in the diagram in Appendix One, in the Macro International Report and in the Strategic Plan Budget.

## VI. RISK MANAGEMENT AND RISK MANAGEMENT OF SYSTEM ARCHITECTURE

Risk management activities are more fully described in this Appendix, Section A9, but will entail obtaining a risk management system that will provide for adequate operational audits, credit and asset quality audits, compliance reviews, independent asset appraisals, supervision, enforcement and liaison with outside, independent auditors. It will include annual reviews and audits of all service bureaus providing trust services under delegated authority from AITDA. Of special interest are the risks associated with point to point and client/server computing and the Board of Directors should encourage the development and implementation of sound policies, practices, or procedures and controls over client/server computing environments.

The traditional approach to data processing for banking functions has been to develop and use large mainframe or midrange systems which are expensive to acquire and maintain. These systems require special physical environments and lengthy application development processes. Application developers have not always kept up with development requests that would allow financial institutions to provide faster delivery of services and products. End-users, who need immediate solutions, have become frustrated with this traditional approach to data processing. New technology is now available, at a perceived cost savings, that could satisfy end-user demand for more timely management information system solutions. This new technology is being proposed by the Strategic Plan.

End-user needs have led to increasing acquisitions of computers and commercial off-the-shelf programs by departments, business units, and individuals to reduce their dependence on a centralized data processing environment. However, this strategy has its own limits. For example, stand-alone computers make it difficult to share information with other information systems. This problem is being solved by the development of high-speed data transmission and network file servers in client/server computing.

As a result, financial institutions are now processing mission-critical applications including funds transfer, branch automation, general ledger reporting, security portfolio accounting, and customer relationship management on point to point and client/server systems or hybrids, thereof. Additionally, independent service providers (service bureaus) are also utilizing this new technology by providing these systems as part of their servicing operations to financial institutions.

It is the responsibility of the Board of Directors of financial institutions to develop and adopt appropriate policies, practices, or procedures covering management's responsibilities and controls for all areas of point to point and client/server computing activities. Management must recognize that the implementation of controls is just as important in the computing environment as in the mainframe environment. The institution's strategic planning should clearly define the technological and control architecture. End-users and auditors must have a prominent role in the acquisition, development, and implementation of all computing environments.

The existence of policies, practices, or procedures and the management supervision of client/server activities should be evaluated by the Board during regular reviews.

*Definition*

Client/server computing is a method of allocating data processing resources in a network so that computing power is distributed among workstations in the network. This type of computing allows integrated applications (general ledger, demand deposit accounting, loans, leases, contracts, etc.) to share system and data resources using cooperative processing. Cooperative processing differs from traditional mainframe or distributed system processing in that each processing component is mutually dependent.

Point to Point architecture is a service architecture using a central database in taking data inquiry or deposit information from data originators or end-users. The Strategic Plan proposes such an architecture, customized to evolve into a client/server configuration at any location where the need is justified.

*Concerns*

The proliferation of new point to point and client/server technology introduces new risks as well as benefits. In today's competitive environment, new computing technology can be a strategic initiative of the organization, and therefore is not just a technological concern, it is also a business concern. Customer demand for flexible and timely management information has fostered its growth. Faster delivery of services, ability to leverage emerging technology, autonomy of end-users, and productivity gains from re-engineering the work flow are all potential benefits.

The new architecture has not evolved to the point where controls are inherent in the design, maintenance, and operation of the system. Controls are more difficult to implement effectively due to the distributed, decentralized and complex nature of the new computing environment. The concerns that appear below illustrate some of the risks and controls that have been associated with the new technology.

This discussion also identifies components and characteristics of client/server computing.

*Concerns to address*

Security

1. Adequate physical security for critical hardware components may not be present due to the distributed nature of the environment and the slow security development of conscious cultures in the computing arena.

2. Inadvertent or intentional unauthorized end-user access to software and data presents greater risk of loss in computing environments due to a potential dependence on the end-user to implement some system functions.

Adequate steps should be taken to ensure protection from unauthorized access, use of, or changes to, systems or data.

Procedures should be implemented to ensure the privacy and confidentiality of information.

Computer Operation

1. Disaster recovery and business continuation plans may be incomplete or outdated due to more frequent changes to hardware and software resources.

2. Exposure to system failures may be increased due to easier software virus infiltration in distributed environment.

3. Incomplete hardware and software inventories could result in additional exposures in the form of unidentified network operations and/or the lack of adequate insurance coverage.

4. Management information systems that rely on untested systems could become incomplete or inadequate due to the lack of adequate operational controls.

5. The lack of or inadequate network configuration diagrams could result in ineffective management oversight.

Procedures should be adequate to ensure the timely, accurate, and complete processing of information. Management should ensure that critical systems and operations are recoverable in the event of a disruption in service.

Implementation and maintenance

1. Internal control considerations could be neglected due to the shortened time frames commonly found in the development of client/server and point to point systems.

2. System failures resulting in weaknesses not identified in pre-implementation testing are more likely to occur than in mainframe environments.

3. There are increased risks from unauthorized modification of application programs due to the distributed location of the client and its applications.

4. Application development costs may consistently be underestimated if a system development life cycle methodology is not used.

5. Failure to re-engineer the work flow in the design phase of the application may limit management's ability to optimize the benefits from this technology.

Appropriate procedures including a system development life cycle methodology should be included in new and existing client/server systems.

Systems software

1. In this heterogenous environment (i.e., consisting of multiple platforms), there is an increased vulnerability to incompatibilities in installed software versions. Thus modifications may cause inconsistent operating results.

Management should ensure that systems are properly tested and approved and that modifications are properly implemented.

Database Management Software

1. Database integrity may be corrupted by deficiencies in the quality of the implementation and the administration of database management systems.

2. Lack of database integrity is of greater concern due to concurrent updates of distributed databases which may not have properly established locking capabilities.

3. Unauthorized access to the data could occur as a result of inadequate database administration or improper data ownerships.

Management should ensure that controls are implemented to ensure the integrity of transactions and that systems are properly tested and approved and that modifications are properly implemented. Management should determine that adequate version control procedures are properly implemented and that the database management system has adequate recovery capabilities.

Middleware

1. System integrity may be adversely effected due to multiple operating environments attempting to interact concurrently.

2. Lack of proper software change procedures across multiple platforms could result in a loss of system integrity.

Management should ensure that controls are implemented to ensure the integrity of the point to point and client/server networks and that systems are properly tested and approved and that modifications are properly implemented. Adequate version control procedures should be properly implemented as well.

**VII. Integrated Organizational Structure**

As noted, the Strategic Plan would create an organizational structure in a manner that optimizes and promotes the performance of the Federal Government’s trust management business processes, the execution of its trust responsibility, and the delivery of its services and products to its clients and the American Indian trust beneficiaries. Because the execution of the trust responsibilities and the delivery of services are primarily dependent upon the performance of its business processes, the most effective and efficient method to establish such an alignment would be to base its organizational structure on its business processes.

There are three fundamental and distinct business groups: (1) Trust Funds Management (2) Land Title and Records Management and (3) Trust Resources Management. The most appropriate organization for these fundamental process groups would be a structure that establishes distinct but inter-related organizational entities under a single administration such as the American Indian Trust and Development Administration.

**VIII. Specific action requirements**

The Strategic Plan proposes such an administration and Phase I of the Strategic Plan is designed to bring it about and to bring the trust management and trust management information systems up to commercial standards within 2 years. The specific initiatives are more fully discussed in this Appendix and, at a minimum, will involve acquiring, automating, updating, integrating, coordinating and consolidating to produce:

*I. A Single Organization to Manage Trust Management Activities.*

This will involve consolidating trust resource, trust funds and land ownership and records management processes into a single, independent institutional unit with its own management structure to accommodate the restructuring and reorganization contemplated by Phase I of the Strategic Plan. The unit should be organized by function and dedicated exclusively to trust management. The unit should be managed by a full-time Chairman and a Board of Directors appointed by the President and confirmed by the Senate. The unit’s proposed organizational form is as an independent government sponsored enterprise subject to Congressional oversight.

*II. A Trust Asset and Accounting Management System.*

This will involve acquiring and implementing a Trust Asset and Accounting Management System which will:

A. Provide a new asset management information subsystem for land and natural resource management and a delivery system for asset leasing, contracting, lending, buying and selling, together with standardized and/or integrated asset management, credit and operating policies, procedures and practices. The system must be able to tie to and track from land and ownership records.

B. Provide an accounts receivable/master lease subsystem data, tickler and collection system that uses lease-contract and ownership information for trust income verification, reconciliation, billing, payments, collection, accounting, disbursement, audit, asset quality review and compliance purposes.

C. Provide an accurate and timely trust, depository, payments and delivery system for IIM accounts and tribal accounts. This will entail purchasing a trust, depository, payments and other financial services accounting and statement system and a delivery system to more efficiently provide current financial services and to facilitate new and improved financial services to individual Indians and Tribes.

D. Provide a general ledger and general accounting system to accommodate all present and proposed TAAMS systems and other improvements.

E. Be preceded by an initiative to clean-up IIM records and the appraisal back-log prior to conversion or after conversion as appropriate.

F. Conform to the general systems architecture described in this Appendix and the Strategic Plan Budget.

*III. A Land Records and Title Recordation and Certification System.*

This will involve the acquisition of a new system which will:

A. Be capable of instantaneous linkage with the TAAMS and other systems used by the service bureaus providing trust services under delegated authority from AITDA in the near term.

B. Be brought up to private sector standards through LRIS-2 upgrades and implementation in the medium term.

C. Be preceded by a clean-up of land and chain-of-title records and back-logs.

D. Conform to the general systems architecture described in this Appendix and the Strategic Plan Budget.

*IV. A Probate Back-log clean-up which is more fully described in this Appendix and the Strategic Plan Budget.*

*V. A Dedicated Technology Services Center.*

This will involve obtaining a centralized technology services center dedicated to trust resources, trust funds and land ownership and records trust management processes with appropriate provisions for disaster/recovery and back-up capability.

*VI. A National Archives and Record Center.*

This will involve obtaining and centralizing a modern national archives and records center for trust asset and accounting management records and land title and records storage and retrieval along with appropriate disaster recovery protection. Implementation of modern imaging technology should be at the fore-front of the improvement initiatives.

*VII. A Risk Management and Control System.*

This will entail obtaining a risk management and control system that will provide for adequate operational audits, credit and asset quality audits, compliance reviews, independent asset appraisals, supervision, enforcement and liaison with outside, independent auditors. It will include annual reviews and audits of all service bureaus providing trust services under delegated authority from AITDA.

*VIII. Legislation on Fractionated Ownership of Indian Lands.*

Legislation is needed which would consolidate the large number of existing fractionated interests and prevent further fractionation. This alone would remove a primary obstacle to the efficient administration of the trust management systems and provide a major catalyst for the timely resolution of most of the operational problems associated with trust management activities, including trust resource and realty management, probate, land titles and ownership records management, IIM accounting, collections, deposits, investments and disbursements, customer service and record keeping for all trust management activities.

*IX. Finally, such systems and organizational improvements must be accompanied by significant legal changes, including adoption of the prudent investor rule.*

*X. A significant investment to clean-up:*

Probate Backlog

IIM and Tribal Records

Appraisal Backlog

LTRO Title Defects

XI. A significant training investment for all trust management activities, including tribal users.

XII. The acquisition and retention of competent management.

These systems improvements and other initiatives will address and resolve the vast majority of the problems listed below:

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**Strategic Plan Major Data Conversion, Reconciliation & Backlog Problems to be Addressed:**

| | Amount | Transactions |
|---|---|---|
| **Tribal Reconciliation Project Disclosures** | | |
| Transactions without source documentation | $2.4 billion | 32,319 |
| Amount with incomplete disbursement voucher packages | $4.1 billion | |
| Amount without source documentation for unreconciled disbursements | $575 million | |

| | | |
|---|---|---|
| Universe of leases and transactions | | Unknown |
| **Probate Related Backlogs** | | |
| Backlog of cases at Agencies | | 3,500 |
| Backlog of cases at Administrative Law Judges | | 3,453 |
| Number of TSRS, Recordation, Imaging & Mapping Documents for research at LTROs | | 212,381 |
| **Land Title and Records Offices** | | |
| Number of Defective Titles to research | | 4,300 |
| Number of Defective Titles - Muskogee Area | | 4,942 |
| Number of Pre-1966 Statutes of Limitations Cases to research | | 25,000 |
| **Leases to be imaged** | | 60,000 |
| **Appraisals to be made** | | 36,000 |
| **IIM Files Information** | | |
| Number of flies to be researched and given document check/reconciliation prior to conversion | | 749,000 |
| "Whereabouts Unknown" riles with no address or incorrect address | $27.7 million | 45,624 |
| Former minors accounts with positive balances or "Whereabouts Unknown" | $21.7 million | 27,519 |
| Overdraft Interest Clearing Accounts mis-posted | $42.2 million | |
| General Ledger losses not cleared | $28 million | |
| Number with no tax identification or social security number | | 128,393 |
| Duplicate Accounts | | 16,828 |
| Special Deposit Accounts with no activity last eighteen months | $2.3 million | 6,119 |
| Number of accounts with $0 balance and no activity last thirteen months and not closed | | 14,476 |
| Number of accounts with balance $0 to $1 with no activity for thirteen months | | 14,906 |
| Number of accounts with no activity for eighteen months and not coded for deletion | | 28,114 |

**Strategic Plan Data, Reconciliation & Backlog Clean-up Summary**

| | | |
|---|---|---|
| | Clean-up Backlog Problem | FY1997-2001 ($ thousands) |

| | | | |
|---|---|---|---|
| **1. Probate Related Backlog Clean-up** | | | |
| Agency | 3,500 | Probates | 1,140 |
| Administrative Law Judges | 3,453 | Probates | 2,430 |
| LTRO | 212,381 | TSRS, Recordation, Imaging & Mapping Documents | 9,425 |
| **2. File Clean-up, D2t2/Document Check** | 749,000 | IIM Files Document Verification | 7,400 |
| **3. IIM Lease Subsystem Conversion** | | File Conversion/TestingfReconcillation | 2,215 |
| **4. LRIS Conversion/Ownership Reconciliation & Defective File Clean-up & Reconciliation*** | 4,300 | Defective Titles. Must be researched and cleared | 9,600 |
| **5. Imaging** | 60,000 | Image 60% of high dollar leases in two years: | 3,160 |
| | | Image remaining leases in FY2000 and FY2001: | 1,000 |
| **6. Appraisals** | 20,000 | Appraisals of 20% of high dollar assets Yrs. 1&2: | 16,000 |
| | 81000 | 5% Appraisal Sampling of other assets: Yrs. 1&2: | 4,000 |
| | 4,000 | Appraisals of renewing high dollar assets - Yrs. 4&5: | 6,400 |
| | 4,000 | 5% Appraisal Sampling of other assets - Yrs. 4&5 | 4,000 |
| **TOTAL** | | | **65,770** |
| **TOTAL FOR FY 1997 THROUGH FY 1999** | | | **48,945** |

***** Does not include$13.3 million to research and clean-up 4,942 defective titles for Muskogee Area and $38.5 million to research and clean-up about 25,000 pre-1966 Statutes of Limitations cases allowed under the Indian Claims Act of 1982. These costs should be included in DOI's operating budgets.

# ORGANIZATIONAL STRUCTURE AND MANAGEMENT FOR TRUST MANAGEMENT ACTIVITIES

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The Strategic Plan proposes a single organization which will manage the U.S. Government's trust responsibilities to American Indians and American Indian Tribes for trust resource management, trust funds management and land title and records management (collectively, trust management activities).

This will involve consolidating trust management activities into a single, independent institution with its own management structure to assume the responsibility for the reforms identified in the Strategic Plan, to implement the reforms over a two year period and to provide for the ongoing management and administration of the U.S. Government's trust responsibilities to American Indians for trust management activities. The institutional unit should be organized by business line or function and should be dedicated exclusively to trust management activities. The institutional unit should be managed by a full time Chairman and Chief Executive Officer and a Board of Directors appointed by the President and confirmed by the Senate.

The unit's proposed organizational form is an independent Government Sponsored Enterprise subject to Congressional oversight. The unit's generic name is referred to throughout the Strategic Plan as the AITDA.

As noted, three of the four primary causes of the longstanding trust management problems involve serious management and organizational structure weaknesses. Management has been principally responsible for the failure to address and resolve the longstanding trust management problems and for the permanent damage to the core trust management systems the government uses to manage the Indian lands and monies. These defective systems prevent the government from meeting the fiduciary, accounting and reporting standards required by the American Indian Trust Fund Management Reform Act of 1994 and standards of ordinary prudence applicable to all trustees, public or private.

So long as the organization and management of the trust management activities remain status quo and as long as the trust management activities are mingled with general trust functions and other government programs and activities, it is unlikely that any meaningful reforms will be implemented and unlikely that these activities will receive appropriate allocations of financial and managerial resources sufficient to allow them to be administered according to the high moral obligations and trust and exacting fiduciary standards the United States has undertaken and assumed. For these reasons, the Special Trustee believes that the Department of the Interior and the BIA do not have and will not have the financial and managerial resources to undertake and implement the reforms proposed by the Strategic Plan.

The Special Trustee, therefore, has proposed a new organizational and executive management structure to address and resolve the long standing trust management problems and to ensure that the Federal Government fulfills its trust responsibilities to American Indian trust beneficiaries. AITDA has distinct advantages over the current structure. The reorganization will:

1. Stop and reverse the steady erosion of the Federal Government's fulfillment of its trust responsibilities (de facto "termination") currently occurring because of lack of financial and managerial resources (capacity) and the unwillingness to address and resolve the longstanding trust problems.

2. Clearly establish accountability both to American Indians and the U.S. Congress and American people.

3. Establish an organization focusing and specializing exclusively on trust management activities.

4. Create an organization which will function with a greater degree of independence and at a higher level in government than BIA. As a GSE and consistent with the treatment of other GSEs, Congress is more likely to provide appropriate financial and managerial resources to ensure the success of the new organization than exists at present.

5. Establish a five person Board of Directors appointed by the President and confirmed by the Senate who will devote full time to the governance and management of the new organization. Three of the Board members will be American Indians proposed to the President by Indian Country. This will assure high level advocacy of issues important to Indian Country and accountability to Indian Country. Two of the Board members, including the Chief Executive Officer, will be experienced and skilled financial and trust asset and accounting managers. This will assure competent management at the most senior levels of the organization.

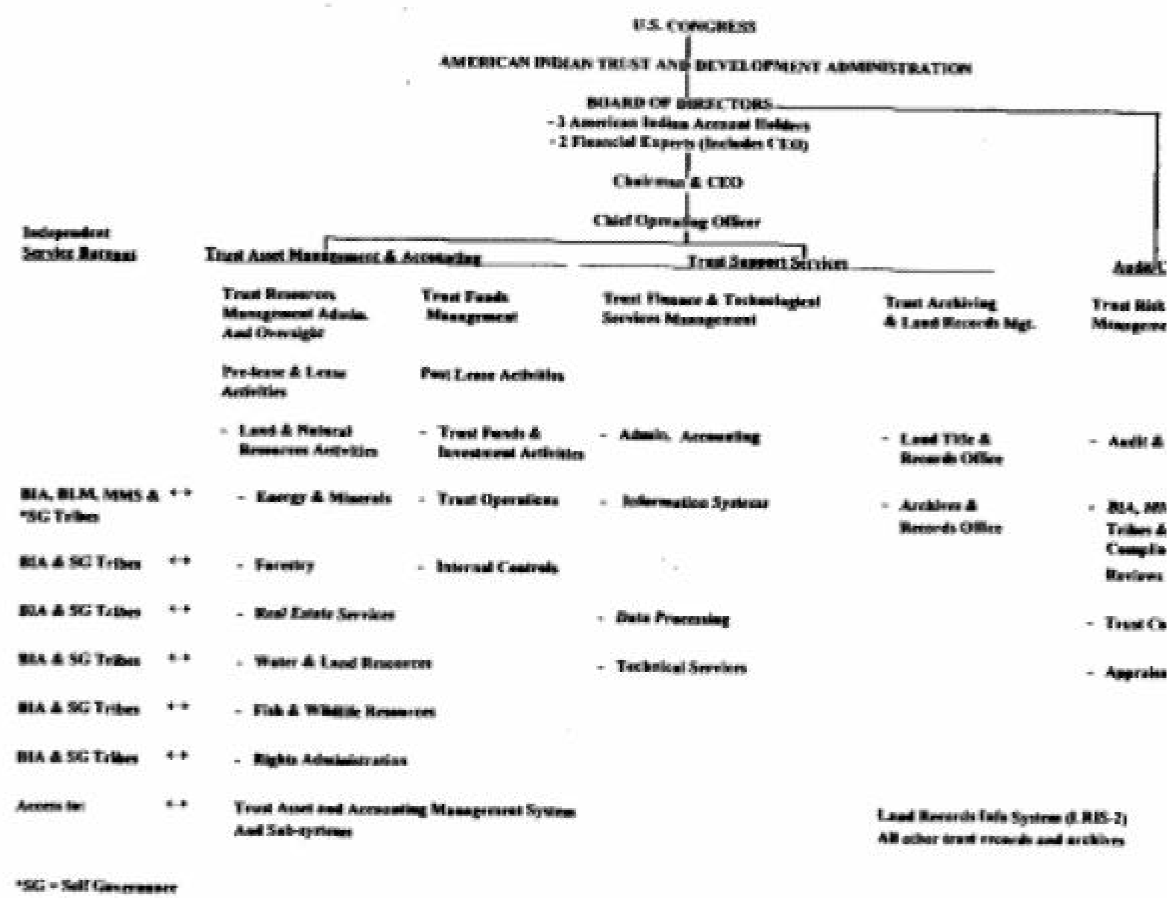
6. Attract, train and retain competent senior management, skilled and experienced in trust asset and accounting management and capable of managing a modern trust operation. This will be facilitated by making AITDA a government sponsored entity. AITDA, like other GSEs, will be exempt from government hiring rules and compensation ceilings and will therefore be able to compete with the private sector in attracting competent management.

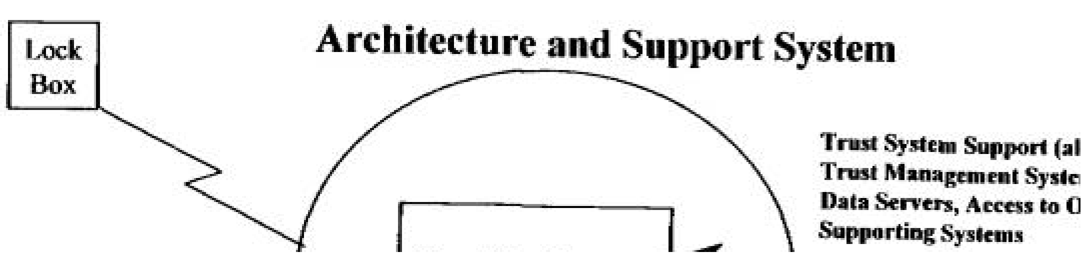
7. Allow AITDA to assess, train, evaluate, compensate on a competitive basis with the private sector and replace, if necessary, those employees transferred from DOI to AITDA.

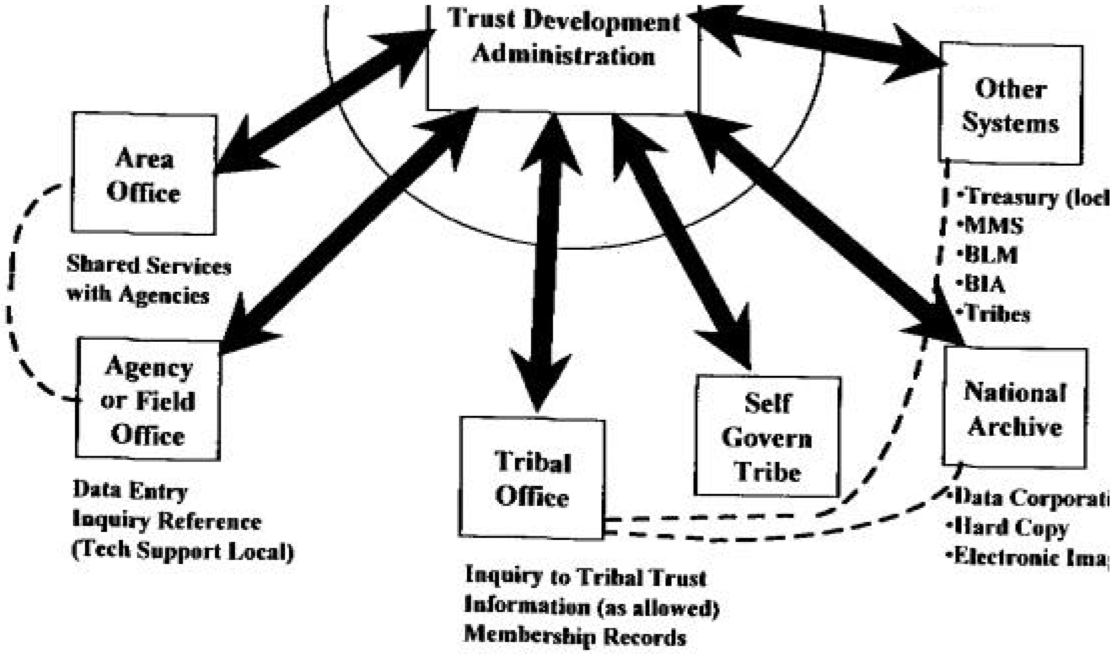
8. Accelerate the process of self-governance by the Tribes. The proposal would not interfere with the Tribes' ability to contract or compact for trust functions since the Self-Determination Act and Self-Governance Act would still be applicable to these programs. Like a private trustee, the proposed administration of the trust activities would rely on a common set of laws, policies, practices, regulations and a common Trust Asset and Accounting Management System and a means through annual audits and reviews and administrative oversight and supervision to assure performance by the Self-Governance Tribes. The Self-Governance Tribes would act as service bureaus under delegated authority from AITDA to provide trust management services for which they had expertise. Thus, increasingly in the future, service bureau management of nearly all of the trust management activities could and should be provided by qualified Tribes or American Indians, themselves, under appropriate compacts and contracts, subject to the rules, oversight and supervision of the Federal Trustee.

The Board of Directors and executive management of AITDA will manage and administer, directly and indirectly, all trust asset and accounting functions, including trust resources management and trust funds management; trust financial and information services management; trust land title and records services; trust records and archiving; and risk management. The Trust Risk Management unit will report directly to the AITDA Board of Directors and will conduct operational, credit and compliance reviews and audits of AITDA units and outside servicers such as BIA, MMS, BLM, Self Governance & 638 Tribes and others. These service bureaus will contract with AITDA to provide specified services under delegated authority and will be subject to AITDA's oversight and supervision.

The organization chart for AITDA and the Systems Architecture are as follows:



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## TRANSFER OF TRUST AUTHORITY, BUDGETS AND CERTAIN STAFF FROM DOI TO AITDA

### ROLE OF THE BUREAU OF INDIAN AFFAIRS, MINERALS MANAGEMENT SERVICE, THE BUREAU OF LAND MANAGEMENT, SELF-GOVERNANCE & 638 TRIBES AND OTHER SERVICERS IN FUTURE TRUST MANAGEMENT ACTIVITIES

At the inception of the American Indian Trust Development Administration, the trust responsibilities, duties, budgets and certain staff engaged in trust resources management, trust funds management and trust land and records management will be transferred to AITDA from the Department of the Interior. This will include all statutory authority, funding and staffing, except as noted below, including those that are in the Tribal Priority Allocation part of the President’s Budget.

At inception all authority, budgets and staff of the Office of Trust Funds Management and the Land Title and Records Office along with staff engaged in the operation of the Land Records Information System and budgets will be transferred to AITDA. Employees transferred or hired will be assessed, trained and closely evaluated on their qualifications and performance and replaced as necessary.

Staff of the BIA, MMS, BLM and Self Governance Tribes engaged in the management of Indian land and natural resources, including all pre-lease and pre-contracting activities and lease and contract origination, will remain in place. AITDA will contract with these units and they will serve as service bureaus for the indicated trust services and activities.

| | |
|---|---|
| BIA & Tribes (Self Governance & 638) and third parties | Land and natural resource management, except post leasing and post contracting activities and records and information system management, unless otherwise contracted. |
| BLM & Tribes (Self Governance & 638) and third parties | Production verification at lease site for oil, gas & coal. Environmental compliance from point of production through closure. Includes all current activities except records and information system management, unless otherwise contracted. |
| MMS & Tribes (Self Governance & 638) and third parties | Royalty and compliance management for oil and gas, including all current activities except records and information system management, unless otherwise contracted. |

AITDA will delegate certain specified investment or management functions to BIA, BLM, MMS, Self Governance Tribes and other third parties only after exercising care, skill and caution in:

1. selecting a delegee suitable to exercise the delegated function, taking into account the nature and value of the assets subject to such delegation and the expertise of the delegee;

2. establishing the scope and terms of the delegation consistent with the purposes of the governing instrument;

3. periodically reviewing through operational and compliance audits and administrative oversight the delegee's exercise of the delegated function and compliance with the scope and terms of the delegation; and

4. controlling the overall cost and budget by reason of the delegation.

BIA, BLM, MMS, the Self Governance Tribes and other parties that operate as trust servicers and as delegees:

1. will have a duty to the trustee and to the trust to comply with the scope and terms of the delegation and to exercise the delegated function with reasonable care, skill and caution. An attempted exoneration of the delegee from liability for failure to meet such duty is contrary to public policy and null and void.

2. will, by accepting the delegation of a trustee's function from the trustee, submit to the jurisdiction of the Federal district courts or other appropriate jurisdiction and the delegee may be a party to any proceeding in such courts or jurisdiction that places in issue the decisions or actions of the delegee.

3. will operate under the regulations, standards, policies and procedures and the information, accounting and reporting systems issued, established and maintained by AITDA.

For land and natural resources management activities, existing staff of BIA, BLM and MMS and the Self Governance Tribes will remain in place at their current locations. Tribes will be assured the same opportunities and authority that currently exist. AITDA managers will sit down with the Tribes to prioritize programs within its's jurisdiction, thus assuring Tribal input and priorities are met on a local and area basis. Further, the current opportunities of 638 contracting and Self Governance Tribes will remain unchanged and fully available to the Tribes. By focusing the AITDA on the trust management activities which have been transferred to AITDA, the BIA will be free to focus on other programs.

**Name and Structure of Proposed Organization**

The proposed name of the organization will be the American Indian Trust and Development Administration. This is a generic name. The actual name will be decided when the organization is formed by the Congress. AITDA will be an independent GSE similar to the Farm Credit Administration or the Federal Home Loan Bank System with a Chairman and a Board of Directors appointed by the President and subject to Senate confirmation. The Board should be structured in such a way so as to draw approximately equal representation from American Indian trust beneficiaries, including both tribal and Individual Indian Money account holders and from people who have practical experience in fiduciary trust fund, investment and financial management. The Board of Directors and Chairman of AITDA will devote full time to the job.

While AITDA will assume and manage the U.S. Government’s primary trust responsibilities to American Indians and American Indian Tribes in the important areas of trust resource management, trust funds management and trust land and ownership records management, there will be no diminishment of the inherently federal trust responsibilities. Essentially, the United States will retain its full trust responsibility but simply transfers administration from the Department of the Interior to AITDA. AITDA will still be backed by the full faith and credit of the United States. In addition the singular focus on trust management activities, independent status, more dependable funding and a skilled Board of Directors and management team should ensure that the U.S. Government will be able to improve its ability to carry out its trust responsibilities to American Indian beneficiaries. The United States would remain liable for any breach of trust by AITDA.

AITDA will assume responsibility for and manage all current trust activities of the Bureau of Indian Affairs, Minerals Management Services and the Bureau of Land Management regarding American Indian trust resources management, trust funds management and land records and ownership management. As noted BIA, MMS, BLM and Self Governance & 638 Tribes will act as service bureaus under delegated authority from AITDA.

AITDA will be created and extensively governed by Federal statute and will be a GSE of the Federal Government intended to carry out and further governmental policy concerning the Federal Government’s trust management activities concerning American Indians and American Indian Tribes and, under Phase II, the economic development of American Indians and their communities.

AITDA will facilitate and implement efforts and initiatives to make individual American Indians and American Indian Tribes economically more viable under established principles of self-determination.

**AITDA BOARD OF DIRECTORS AND MANAGEMENT STRUCTURE**

AITDA’s Board of Directors shall consist of at least five members appointed by the President and confirmed by the Senate.

1. Three members shall be American Indians appointed by the President after being proposed by

Indian Country in some organized way.

2. Two members, including the Chairman and Chief Executive Officer, shall be people skilled in financial and trust management and may also be American Indians.

TDBank's Board under Phase II shall be identical with AITDA's Board.

All Board Members of TDBank and AITDA will be appointed for a term of 12 years using a staggered system. Initially, two will be appointed for four years; two will be appointed for eight years; and the Chairman & CEO shall be appointed for twelve years. Vacancies which occur prior to the expiration of the term shall be filled with individuals to fill the remaining term of the particular vacancy.

AITDA's Board shall organize itself through governing committee's to oversee the primary operations, including trust resource management; trust funds management; trust land and ownership records management; lending, leasing activities; investment activities; risk management and audit activities; and other banking and trust activities.

All Board members will be full time employees and will be compensated at the same rate paid FDIC Directors or as otherwise determined by Congress.

The Chairman & CEO and other executive management and employees will be qualified bank and trust officers and employees and shall be exempt from Federal Government employment requirements. Compensation and benefits will be determined by the Board of Directors after taking into account general compensation and benefits schedules of the Farm Credit System Banks.

**Aitda General Structure and Relationship to Federal Government**

AITDA will:

- be an instrumentality of the Federal Government and will be backed by the full faith and credit of the United States.
- be governed by a Chairman and Board of Directors appointed by the President and confirmed by the Senate.
- have appropriate oversight from the Congress on an ongoing basis.
- be examined and supervised by an existing (OCC is proposed) or new agency of the Federal Government.
- have a corporate structure patterned after the Farm Credit Administration System.
- have a budget that will be subject to the Federal Government's authorization, appropriations and oversight processes.
- be required to have an annual audit and report from an independent, qualified accounting firm.
- be exempt from all federal and state taxes.

**Board of Directors Discharge of Duties and Responsibilities**

***Organizational Structure Considerations***

The discharge of fiduciary duties and responsibilities by AITDA's directors should be effected through a plan designed to accommodate the volume and types of business handled, local circumstances, and the growth and development of the institution's fiduciary business. An effectively structured organization is important, for although the board may elect to pass directly on all fiduciary matters, some person(s) and/or committee(s) usually is designated to handle administrative and operational matters.

As fiduciary activities expand into the delivery of new financial products and services, the traditional trust management must change correspondingly. New integrated delivery systems and other trust concepts will be introduced by the private sector trust industry in response to competitive pressures. Swift and dramatic organizational changes occur in fiduciary activities, which must meet the tests of sound fiduciary principles and practices. Activities conducted by virtue of possessing fiduciary powers must adhere to the changing standards as they evolve.

The organizational structure of fiduciary activities should be set forth clearly in the records of the institution, either in the bylaws, board resolutions, or written management plans adopted by the board. When the organization of fiduciary activities is complex, such records may designate and prescribe only the duties of the fiduciary activities manager and/or fiduciary committee(s). This arrangement suggests "in-house" assignments of fiduciary functions by the fiduciary department manager and/or committees. Such assignments should be prescribed in writing, and the Board should determine that the manager and/or committees have been assigned that authority by the board. If integrated financial products and services of a fiduciary nature are being marketed or are planned, the underlying requirements remain the same: the bylaws, board resolutions, or written management plans adopted by the board must clearly define organizational relationships, responsibilities, and policies.

The organizational structure should meet the following objectives:

* The organizational structure should be designed to promote an orderly flow of the daily work and be sufficiently flexible to accommodate peak work loads without sacrificing efficiency or accuracy.

* Fiduciary committees should be so structured as to constitute flexible, workable entities. Functions should be clearly defined and effectively executed.

* A plan of organization should include procedures for personnel recruitment, training, evaluation and salary administration. Equal opportunity should be available to all personnel in the administration of those procedures.

* Staff should be sufficient to handle the volume of work. Lines of authority, duties and responsibilities should be clearly defined and effectively communicated to all personnel to promote efficiency, productivity and the orderly execution of the department's functions.

* The organization plan should facilitate the implementation of an adequate program of internal controls and a system of checks and balances designed to ensure proper administration of the institution’s fiduciary business. Such controls should include a procedure for management review of actions taken by all personnel.

* The organization plan should include procedures for effective communication among all levels of management. Procedures should facilitate the dissemination of information necessary to:

- Inform all supervisory personnel of senior management's policies and directives.
- Apprise senior management of its subordinates' activities in implementing such policies and

directives.

- Effect the orderly execution of administrative details.

* Authority to make discretionary decisions and the matters in which independent judgment may be exercised should be defined expressly and communicated to supervisory personnel. Sufficient flexibility should be allowed to permit expedient action where it would be essential to the best interests of a fiduciary customer.

Recruitment of new personnel is an integral part of any management plan. In order to insure continuity in middle and senior management, it is necessary to have an inflow of new personnel at lower levels and adequate training procedures and advancement policies to keep the organization viable and dynamic.

Various types of training should be available. The Board should analyze the type and comprehensiveness of training offered and formulate an opinion about the quality of the program. Examples of training include:

* "In-house" development programs.

* On-the-job training.

* Correspondence courses.

* Banking and trust schools and seminars.

* Facilities of larger trust companies.

* Tuition aid programs.

Senior management should look at the variety of learning opportunities provided and the degree of participation by personnel. Personnel evaluation will reveal whether a program is developing staff properly and provides a sound basis for promotions and salary increases.

***Management Appraisal***

Commencing with the implementation of the Strategic Plan, an outside independent management appraisal of personnel transferred to AITDA from DOI and engaged in trust management activities should be performed for the Board of Directors of AITDA to assist the Board in selecting and placing trust managers in the new organization. The independent appraisal should generally take into account the following criteria. After the initial appraisal an annual appraisal of middle to executive managers should be performed by the Board.

Management appraisal involves the evaluation of the quality of supervision of fiduciary activities. The appraisal includes a review of the qualifications of:

* Personnel designated to manage fiduciary activities.

* Personnel serving on fiduciary policy committees.

* Executive officers having supervisory authority over the trust management activities.

* Non-officer personnel in key supervisory functions.

The appraisal of management covers the full range of functions and activities related to the operation of the Department’s trust management activities. It requires astute judgment based upon observation and information, both objective and subjective, developed during the examination. It represents the collective assessment of management's effectiveness when measured against:

* The size and complexity of the fiduciary activities.

* The distinct character of fiduciary activities.

* The competitive environment.

* Government and private sector trust and fiduciary standards and best prudential practices.

* The capacity and willingness to implement the Strategic Plan reforms.

The effectiveness of management is the result of the complex interactions of many variables, including talent, motivation, resources, and opportunity.

Management of fiduciary activities should be judged on the basis of the ability to service its fiduciary accounts; both those presently under administration and those to which the institution plans to commit in the future.

Although both the directors and management have important roles in formulating policies and establishing programs for the execution of functions, internal control and audits, management alone must implement such policies and programs within the organizational framework instituted by the board of directors. The exercise of fiduciary powers should always conform to the highest standards of professionalism.

Although a major measure of management's ability is the condition of fiduciary activities and the quality of fiduciary services offered, the effect that management will have on future fiduciary activities is highly significant. The depth of planning and the forward looking attitude of executive officers are relevant in assessing that impact.

Two questions should be posed: Is management competent to administer the institution’s fiduciary business? Is management's competence manifested in its performance? The measurement of human qualities is always an elusive task at best, and the board must constantly remain open and innovative in their approach to management appraisal.

In assessing competence, the qualifications of management should be evaluated relative to duties and responsibilities assigned. For example, a fiduciary manager may have limited knowledge of fiduciary matters yet possess the managerial skills necessary to guide the affairs of fiduciary activities effectively. In such a case, the should emphasize the need for fiduciary expertise in middle management levels. Managers generally must be well versed in all facets of fiduciary business engaged in by their institution.

The Board of Directors should consider the following factors in evaluating management personnel:

Education

What is the level of academic achievement and its relationship to the position held?

Training

What is the level of professional training? What schools or seminars has the person attended?

Experience

What is the nature of the person's fiduciary experience? Is such experience relevant to the person's duties and responsibilities?

Character

Is the person's personality, disposition, and reputation consonant with the requirements imposed by assigned duties and responsibilities? Are there any other factors which might cause the person's integrity, reliability or ethics to be suspect?

In appraising management, the board should also consider expertise derived from sources outside the institution. Management may compensate for "in-house" weaknesses, e.g., the administration of investments, taxes and accounting capabilities, by employing outside professional services. In those instances, the board should evaluate management's capacity to utilize the services effectively.

Management will always be somewhat of an art; the talent, experience, vision, courage, and character of managers will be major factors in their performance. On this broader scale, the board may gain additional insight in assessing the quality and effectiveness of management's performance by reviewing:

* Organization.

- Organizational effectiveness.
- Effectiveness of management's span of control
- Management succession and personnel development
- Effectiveness of committees as viewed from the perspective of purpose, need and composition.

* Supervision.

- The exercise of sound management practices.
- Leadership qualities.
- Management's active or reactive approach to the dynamics of the industry.
- Currentness of policies and procedures.
- Employee knowledge of and accountability for applicable policies and procedures.
- Monitoring investment performance of the fiduciary and compared to private sector trust departments and companies.
- Monitoring litigation, complaints, and charge offs; determining their probable cause and, where

deficiencies are found to exist, appropriate remedies.
- Responsiveness to the audit report and the institution's report of examination.

The reports and working papers will serve as the primary source for the board's evaluation of management's performance. It also should provide a basis for evaluating the propriety and soundness of management's decisions and their effect on the future of fiduciary activities.

***Management Information Systems***

For fiduciary activities to succeed in the rapidly evolving financial services industry, management must fully understand the implications of change. Emerging markets must be identified along with the increasing role of technology. An important tool in dealing successfully with those dramatic changes is an effective and responsive Management Information System (MIS).

The MIS should be as unique as the institution and/or fiduciary activities it serves. It should fit the philosophy of the institution and/or fiduciary department's long and short-term goals, internal structures, budgets, and existing communications networks. The board should be aware of certain of the following fundamentals common to a successful MIS.

* It addresses the kinds and frequency of decisions to be made, and by whom.

* It considers information needed and its availability. It then focuses on relevant information and eliminates that which is not useful.

* It evaluates how ideas are communicated within the organization.

* It considers how and where decisions are implemented. It then provides information for the decisions that need to be made.

* It is kept simple. Too often an MIS becomes an end unto itself and ceases to be cost-justified.

* It produces current, accurate and relevant information.

* Managers understand how the system works.

In evaluating the MIS, the board should answer the following questions:

* Does it have the actual support of senior management of the institution?

* Does it produce the information desired?

* Are human considerations weighed independently when making decisions based on the MIS?

* Is it flexible and can it allow for potential changes in growth, strategy, communications, and systems?

* Is it reviewed and evaluated annually by management?

***Institutional Planning***

The increasing competition in the delivery of fiduciary products and services and the dynamic nature of the financial services industry demands ongoing planning. The long-range plan for fiduciary activities is the joint responsibility of senior bank and fiduciary management and should be integrated with the long-range plan for the institution. Long-range planning is a continuous, systematic process of making risk-taking decisions that involve the future. The long-range plan should include the method for its execution and ways of measuring results against expectations. There are three common misconceptions of long-range planning: it is misunderstood to be a means of forecasting the future, dealing with future decisions, or eliminating risks. It is none of these. Instead, long-range planning is necessary merely because the future cannot be forecast; long-range planning consists of making current decisions involving the future. The taking of risks cannot be eliminated, but the risks taken must be the right ones.

The long-range plan provides the focus for fiduciary activities to function successfully. The plan includes its goals, directions, and expectations and alerts management to the decisions, commitments, and efforts of fiduciary personnel.

Much can be written about the merits of the "top down" versus the "bottom up" approach to long-range planning. In general, a balance between the two methods often results from the prevailing circumstances in the institution. Regardless of the predominance of one method over the other, the planning process should involve the participation of management at all levels. Through their participation, managers and supervisors can become more creative and gain a more comprehensive understanding of the challenges confronting fiduciaries.

Until recently, contingency planning was relatively uncommon in banking fiduciaries. However, the rapid and dramatic changes occurring in the financial services industry have made it imperative that the long-range plan allow for the occurrence of various contingencies. The contingency plan permits management to adjust quickly or exploit opportunities when possible events become reality.

The following should be considered when evaluating the fiduciary activities long-range planning process:

* Is long-range planning a continuous, ongoing process that improves responsiveness to internal and external changes?

* Is the long-range plan integrated and compatible with the long-range plan for other institutional activities?

* Does the long-range plan include programs for its implementation and are they directed effectively?

* Are there provisions in the long-range plan for contingencies?

* Is the long-range planning process cost effective?

* Does management monitor the long-range plan by reviewing feedback information to measure results?

* Has the long-range plan, or portions thereof, been disseminated to all managers and supervisors that have a need to know?

### *Financial Performance*

A significant measure of management's effectiveness is the financial performance of fiduciary activities. This will be a new concept for the Federal Government’s fiduciary activities, but fees for fiduciary services will be introduced by AITDA and cost control emphasized throughout the institution. The board should review that performance with management. The review should include the quality and trend of earnings, management and environmental factors, and the prospects for future earnings. Capital adequacy, asset quality and liquidity should be rated and reviewed as well. The performance of fiduciary activities, as perceived by management, should be weighed against the results of that review.

Developments in the fiduciary industry have emphasized the need to standardize approaches to trust profit accounting. "Measuring Trust Profitability," published by the ABA in October 1979, developed the following five guidelines for a trust profit accounting plan.

* Fiduciary income should be defined as though the department were an independent organization.

* Earnings credited on customer balances (where the relationship is fiduciary and the fee has not been reduced by the value of balances) should be categorized as nonoperating income.

* "Consumable expenses" are all the costs incurred, whether direct or indirect, in administering, operating and marketing the activities of the department.

* Allocated corporate overhead is considered nonoperating expense.

* Income and expense by service and product lines form the basis for analyzing profitability.

Regardless of how financial performance is accounted for, management must strive to operate on a safe and sound basis. The most useful management tool for directing fiduciary activities to sustained safety and soundness is an effective cost accounting system. A well designed system can provide much of the critical information required to make sound financial decisions. An effective cost accounting system permits management to consider the following alternatives:

* Determining cost by:

- Service and product lines.
- Type of transaction.
- Individual account.
- Individual administrator.
- Office, section, division.

* Assessing the potential profitability of accounts prior to their acceptance.

* Establishing a flexible and sound pricing policy that can be adapted to prevailing market circumstances and provide options based upon:

- Time required.
- Type and number of transactions.
- Level of skill, knowledge and responsibility required.

- Schedule of fees.

* Screening out unprofitable accounts.

* Changing the mix of products and services to be more profitable.

* Focusing on areas of low productivity.

* Utilizing an ongoing training program to counter declining productivity, employee turnover and shortages.

* Lowering production costs.

* Reducing staffing.

* Automating fundamental services and reducing the costs of delivery systems through economies of scale.

* Integrating services and product lines, where possible.

Management must be informed sufficiently about financial performance to be able to make appropriate decisions when dealing with adverse variances in operating results. Uncontrolled fiduciary activities will eventually lower the quality of services, which, in turn, will further aggravate financial performance and reflect adversely on the institution. Management can achieve safe and sound operations only by knowing the costs.

***New Product Development***

Expansion of the financial services industry presents new opportunities for all fiduciaries. With greater emphasis placed on customer service, the financial expertise found in fiduciary activities is being called upon. The deregulated environment in which private fiduciaries compete places considerable emphasis on the introduction of new financial products and services. The ability to react successfully to those markets can affect the institution's future significantly.

Product superiority can provide an advantage. AITDA must offer products which are the equivalent of those in the marketplace if its American Indian beneficiaries are to be well served. At the same time, AITDA must be able to respond rapidly to changes in regulations, competition, and consumer interests. Customers of financial products and services are becoming increasingly sophisticated and capable of making sound value judgments concerning such products and services. Often, the customer of financial products and services is influenced more by their quality and value than by institutional loyalty to their sponsors. As marketing philosophy shifts from a product orientation to a broad range of financial products and services, marketing efforts must become more entrepreneurial.

The initial requirement of any successful marketing approach is the full support of fiduciary activities management. AITDA will initially lack the financial means and geographic location to serve all potential markets. Because of these limitations, market research must identify consumer needs and determine which market segments are compatible with AITDA's capabilities. Caution must be exercised to work within the limits of managerial and financial resources as well as to assess advantages. Market segmenting involves identifying potentially large customer groups and deciding where emphasis should be concentrated. In addition to determining key market segments, delivery systems must be established to serve them.

Meeting consumer needs involves providing current products and services to new customers or new services to existing customers. New products and services should be market-tested beforehand and a cost effective means of delivery determined. Pricing is usually a combination of three variables cost, customer's willingness to pay, and linkage to other products and services of the bank. When financial products and services are integrated with the bank through relationship banking, a cooperative marketing approach is essential.

# TRUST ASSET ADMINISTRATION: POLICY AND PROCEDURES

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The primary function of a fiduciary is the management of property for others. The potential investments for consideration by fiduciary institutions have expanded considerably in recent years. Asset administration and its component work programs focus on such complex issues as the selection, purchase, management and sale of assets to meet the needs of various classes of beneficiaries. This section addresses the administration of the different forms of assets that may be found in fiduciary accounts.

Fiduciary asset administration is regulated largely by prudent person standards, common law principles, state and Federal laws and regulations, and industry practices. However, a trustee is provided with considerable latitude to express an individualized investment style and develop investment alternatives.

One role of the trustee in asset administration is to identify assets which may be appropriate investment vehicles. The trustee must also administer those fiduciary assets for the exclusive benefit of the beneficiaries. In a true fiduciary relationship, the trustee has legal ownership of the trust property and is accountable to the beneficial owners for management of those assets. The trustee must be concerned with both the legality and prudence of each investment. Under common law, a trustee must use the same amount of care, skill and caution in making investments as a prudent person would to preserve the estate and the amount and regularity of income. However, under common law principles, a corporate fiduciary may generally be held to higher standards of care, skill and caution, than one trustee.

The ultimate responsibility for the proper exercise of fiduciary powers lies with AITDA's board of directors. The board may assign to officers or committees the authority to make and monitor investment decisions. The extent of such assignment will vary with the size, volume of activity, and complexity of the fiduciary and may include establishment of policies, approval of discretionary actions, and periodic review of accounts. Accurate records should be maintained of investment decisions and review procedures.

AITDA should have an investment policy approved by the board of directors which includes an overall statement of investment philosophy and details the responsibilities of committees and officers involved in the investment process. It should address, among other things, investment quality standards and procedures to evaluate asset portfolio guidelines, diversification requirements, risk assessment procedures, account reviews, use of common trust funds, broker/dealer selection, and safeguards against conflicts of interest and self-dealing. Specifically, policies, procedures, practices and systems should be adopted by the board of directors covering:

Fiduciary Asset Administration Policies & Practices

The establishment of a written asset management policy by the trustee provides the foundation for sound portfolio management. Throughout this Strategic Plan there is considerable emphasis on the establishment of formal written policies by the board of directors and on their being implemented, administered and amplified by management. That is perhaps most important in the asset management and administration function. The board of directors, in discharging its duty, must ensure that assets in the portfolios are made with the following three basic objectives in mind:

1. To invest profitably for the benefit of the trust beneficiaries.

2. To manage assets on a safe and sound basis.

3. To serve the legitimate needs of the community in which the Indian beneficiaries are located.

The asset management policy should contain a general outline of the scope and allocation of the institution’s leasing and contract facilities and the manner in which assets such as leases and contracts are managed, serviced and collected. The policy should be broad in nature and not overly restrictive. The formulation and enforcement of inflexible rules, not only stifles initiative, but also may, in fact, hamper profitability and prevent the institution from serving the community's changing needs. A good policy will provide for the presentation, to the board or a committee thereof, of asset leases and contracts that officers believe are worthy of consideration but which are not within the purview of written guidelines. Flexibility must exist to allow for fast reaction and early adaptation to changing conditions.

In developing the asset administration policy, consideration must be given to the institution’s available financialresources, personnel, facilities and future growth potential. Such guidelines, however, must be void of any discriminatory practices. A determination of who will receive a lease, a contract or a credit, and of what type and at what price, must be made. Other internal factors to be considered include who will grant the lease, the contract or the credit, in what amount, and what organizational structure will be used to ensure compliance with the institution’s guidelines and procedures. As authority is spread throughout the organization, the institution must have efficient systems for monitoring adherence to established guidelines. That can best be accomplished by an internal review and reporting system which adequately informs the directorate and senior management of how policies are being carried out and provides them with information sufficient to evaluate the performance of lower echelon officers and the condition of the asset portfolios.

There are certain components which generally form the basis for a sound asset administration policy, but they are not necessarily applicable in every location. Generally, the policies, procedures, systems and practices should address the following general areas and be responsive to the questions listed.

Asset Pricing-Rates on various lease and contract types established by the policy must be sufficient to, among other things, cover the costs of servicing the lease, including general overhead and of probable losses while providing for a reasonable margin of profit for the beneficiary. Policy makers must know those costs before they establish the rates. Periodic review allows the rates to be adjusted to reflect changes in costs or competitive factors. Rate differentials may be deliberately maintained either to encourage some types of lessees to seek business elsewhere or to attract a specific type of lessee. Specific guidelines for other relevant factors such as fees on commitments, are also germane to pricing policy.

The policy should outline where the responsibility for appraisals lies and should define formal, standard appraisal procedures, including procedures for possible reappraisals in the case of renewals or extensions. Acceptable types of appraisals and limits on the dollar amount and type of real property that are authorized to appraise should be outlined. Circumstances requiring appraisals by qualified independent appraisers also should be described. Leasing/contract criteria vs. amount to appraised value, the method of valuation and the differences for various types of property should be detailed. The policy also should contain a schedule listing the down payment requirements, if applicable.

Extensions of leases, contracts and credit of other types on a safe and sound basis depends on complete and accurate information regarding every detail of the contract party's credit standing. Current and complete financial information is necessary not only at the inception of the lease, contract or credit, but also throughout the term. The policy should define the financial statement requirements for businesses and individuals at various leasing/contract/credit levels and should include requirements for audited, non-audited, fiscal, interim, operating, cash flow, and other statements. It should include external credit checks required at the time of periodic updates. The requirements should be defined in such a manner that any credit data exception in an examination or audit report should be a clear violation of the institution's policy.

The policy should strive to develop diversification within the portfolio and to obtain a balance between maximum yield and minimum risk. Concentrations of leases/contracts/credit depend heavily on a key factor and when weaknesses develop in that key factor, every individual asset making up the concentration is affected. The directorate should evaluate the additional risk involved in various concentrations and determine those which should be avoided or limited. The policy also should require that all concentrations be reviewed and reported on a frequent basis.

The policy should establish limits for all lease/contract/credit officers. If these policies are clearly established and enforced, individual officer limitations may be somewhat higher than would normally be expected, based on the officer's experience and tenure. Limits also should be set for group authority, allowing a combination of officers or a committee to approve larger leases/contracts/credits than the members would be permitted to approve individually. The reporting procedures and the frequency of committee meetings should be defined.

The asset administration policies should define delinquent obligations of all types and should dictate the appropriate reports to be submitted to the board. The reports should include sufficient detail to allow for the determination of the risk factor, loss potential and alternative courses of action. The policy should require a follow-up collection notice procedure which is systematic and progressively stronger. Guidelines should be established to ensure that all accounts are presented to and reviewed by the board for disposition at a stated period of delinquency.

Written policies and procedures approved and enforced in various departments should be referenced in the general administration policy of the organization.

Before an institution grants a lease, contract or credit, its objectives, policies and practices must be clearly established. Before an auditor examines an asset, those objectives, policies and practices should be reviewed to determine if they are reasonable and adequate to properly supervise the portfolio. If written guidelines do not exist, there is a major deficiency in the asset management area and the board of directors is not properly discharging its duties and responsibilities. If no exception is taken to the objectives, policies and practices, the various areas should be examined to determine compliance. That determination is one of the prime examination objectives of a director's examination.

Failure of the directors to establish a sound asset administration policies, of the management to establish adequate written procedures and of both to monitor and administer the asset management function within established guidelines has resulted in substantial problems for many institutions. Some problem areas are:

*Self-Dealing.* Self-dealing is involved in a significant number of serious problem situations.

*Anxiety for Income*. The asset portfolio is usually the most important revenue producing asset. The earnings factor, however, must never be permitted to outweigh that of safety and soundness so that credits that carry undue risks or unsatisfactory repayment terms are granted. Unsound leases and contracts usually cost far more than they produce in revenue.

*Compromise of Credit Principles.* Management, for various reasons, may grant leases and contracts carrying undue risks or unsatisfactory terms, with full knowledge of the violation of sound credit principles. The reasons for compromise of basic credit principles may include timidity in dealing with individuals having dominating personalities or influential connections, or there may be friendships or personal conflicts of interest involved. Self-dealing, anxiety for income, and competitive pressures also may lead to a compromise of credit principles.

*Incomplete Credit Information.* Character and capability may be determined by many means, but complete credit information is the only acceptable and reasonably accurate method for determining an obligor's financial capacity. The lack of supporting credit information is an important cause of "problem" assets. Adequate and comparative financial statements, operating statements, and other pertinent statistical support should be available. Other essential information, such as the purpose of the lease, contract or credit and the intended plan and source of repayment, progress reports, inspections, and memoranda of outside information and conferences, should be contained in the credit files. Proper credit administration and accurate credit appraisal is not possible without such information.

*Failure To Obtain or Enforce Repayment Agreements.* This constitutes a very important cause of asset trouble. Leases, contracts or credits granted without a clear agreement governing repayment are, at the very least, in violation of a fundamental banking principle. Such assets are likely to become problems at some subsequent date. More common, and generally as bad, is the case where the fiduciary has an agreement with the obligor regarding the repayment or progressive liquidation of his lease, contract or credit, but fails to collect the principal payments promptly. It is a sound axiom that good leasing/lending and good borrowing both require consistent liquidation.

*Complacency.* The following items manifest complacency and should always be guarded against: Lack of adequate supervision of old and familiar customers; dependence on oral information furnished by obligors in lieu of reliable financial data; optimistic interpretation of known credit weaknesses based on past survival of recurrent hazards and distress.

*Lack of Supervision.* Many leases and contracts that are sound at their inception have developed into problems and losses because of lack of effective supervision. Ineffective supervision is almost invariably the result of a lack of knowledge of the obligor’s affairs over the lifetime of the obligation.

*Technical Incompetence.* The technical ability to analyze financial statements and to obtain and evaluate other credit information, thereby protecting the fiduciary in the placement and supervision of assets, is possessed by all able and experienced fiduciaries. When it is not, unwarranted losses are certain to develop. Credit incompetence of management should be discussed promptly with the board of directors.

*Poor Selection of Risks.* Lease and contract approval should be based on sound underwriting and risk-selection standards.

The institution’s internal controls, policies, practices and procedures for managing the asset portfolio should be documented in a complete and concise manner and should include, where appropriate, narrative descriptions, flowcharts, copies of forms used and other pertinent information. Generally, the written policies and procedures should be responsive to the following questions and criteria:

1. Has the board of directors, consistent with its duties and responsibilities, adopted written asset portfolio management policies and objectives that:

- Establish suggested guidelines for distribution of asset categories?
- Establish geographic limits for leases, contracts and credits?
- Establish suggested guidelines for aggregate outstanding asset types in relation to other balance sheet categories?
- Establish limit authority of committees and individual officers?
- Define acceptable types of leases, contracts and credits?
- Establish maximum maturities for various types of leases, contracts and credits?
- Establish pricing criteria?
- Establish appraisal policy?
- Establish minimum financial information required at inception of credit?
- Establish limits and guidelines for purchasing assets?
- Establish guidelines for leases to directors, officers and their related interests?
- Establish collection procedures?
- Define the duties and responsibilities of officers and committees?
- Outline portfolio management objectives that acknowledge:
    1. Concentrations of credit within specific industries.
    2. The need to employ staff with specialized knowledge and experience?
    3. Indian community service obligations?

2. Are asset portfolio management policies and objectives reviewed at least annually to determine if they are compatible with changing market conditions?

3. Are the following reported to the board of directors or its committees at their regular meetings (at least monthly):

1. Past due obligations?
2. Total outstanding lease commitments?
3. Assets requiring special attention?
4. New leases/contracts/renewals of significance and restructured leases and contracts.

4. Are reports submitted to the board or its committees rechecked by a designated individual for possible omissions?

5. Are written applications required for all leases, contracts and credits?

6. Does the institution maintain credit files for all obligors?

7. Does the institution require periodic submission of financial statements by all obligors?

8. Is a tickler file maintained to ensure that current financial information is requested and received?

9. Does the institution submission of audited financial statements based on the dollar amount of the commitment?

10. Does the institution perform a credit investigation on proposed or existing obligors for new applications?

11. Are all commitments in writing?

12. Are lines of credit reviewed and updated at least annually?

13. Are obligors' outstanding liabilities checked to appropriate lines of credit prior to granting additional credit?

14. Is there an internal review system which:

1. Rechecks interest, discount and maturity date computations?
2. Reexamines leases for proper execution, receipt of all required supporting papers and proper disclosure forms?
3. Determines that approvals are within the limits of the officers' authorities?
4. Determines that leases and contracts are being approved by the officers?
5. Ascertains that new leases and contracts are within the limitations set for the obligor by corporate resolution?
6. Rechecks liability ledger to determine that new leases have been posted accurately?
7. Rechecks the preparation of maturity and payment notices?
8. Examines entries to various general ledger asset controls?
9. Confirms collateral, leases, contracts and discounts with customers on a test basis?

There follows more specific discussion of the policies, procedures, systems and practices which are proposed by the Strategic Plan in the following areas of asset administration and management:

INVESTMENTS--MARKETABLE SECURITIES

INVESTMENTS--CLOSELY HELD COMPANIES

INVESTMENTS--REAL ESTATE LOANS

INVESTMENTS--REAL ESTATE

INVESTMENTS--MINERAL INTERESTS

INVESTMENTS--MISCELLANEOUS ASSETS

INVESTMENTS--COLLECTIVE INVESTMENT FUNDS

INVESTMENTS--PORTFOLIO MANAGEMENT

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## INVESTMENTS -- MARKETABLE SECURITIES

The term "marketable securities" refers generally to securities in active trading markets where they may be converted readily into cash. They include common stocks, preferred stocks, government securities, corporate bonds, municipal securities and money market instruments. The relative liquidity of those investments generally allows the trustee to convert them into cash more readily than other types of investments.

In general, over extended periods of time, common stock offers potential for both the greatest rewards and the greatest risks among the types of investment securities. Common stock is an ownership security. It guarantees the shareholder the right to share in the earnings of the company through future dividends and price appreciation.

Several advantages accrue to the institutional investor by using common stocks to achieve investment objectives. Needs of income beneficiaries may be met by income from dividend payments. Capital appreciation of stocks increases the value of the trust for the remainderman. Although the current dividend yield may be low, potential for capital gain may be great. Common stocks that are registered on an organized securities exchange also are traded in a more efficient market as opposed to some other forms of investment. Options may be written on some issues for additional income. By selling call options against a stock, the investor receives the premium income, which is added to the yield of the stock. The effect of writing the option is to increase the investor's yield without substantially increasing the risk of investment.

There are four attributes of preferred stock which make that form of ownership attractive to investors:

- The preference of the investor's dividends on the earnings of the company.
- The preference to a claim on assets over common stock in the unusual cases of liquidation, reorganization, refinancing, or adjustment of a company's capital account.
- The partial (85 percent) tax exemption of preferred dividends if owned by another corporation.
- Preferred stock may be convertible into common stock.

Some investors consider preferred stock a hybrid security, possessing all the disadvantages of debt securities and none of the advantages of common stock. However, high-grade preferred stocks have stability of income and security of principal. They do not share in the business or market risks to the extent of common stock. They do share in interest rate and inflation risks.

Debentures convertible to common stock are another investment alternative. Debentures are unsecured bonds protected only by the general credit of the borrowing corporation. The flexibility offered by a convertible debenture may be advantageous to a particular investment program. Normally, those securities combine the characteristics of debentures and common stocks. There also may be a yield sacrifice in comparison to nonconvertible debentures as a result of the conversion feature. Convertibles can limit interest rate risk, i.e., a rise in interest rates depresses the price of fixed income securities, and provides an opportunity to participate in potential capital stock appreciation through stock conversion privileges. If the conversion privilege is not exercised, the bond will pay par at maturity.

The convertible features of both preferred stock and debentures may be complex. If the trustee holds convertible securities, adequate provisions for monitoring call provisions and changes in conversion ratios should be in place. Investment services may be used to monitor those factors.

In making investment decisions regarding common and preferred stocks, and preferred stocks and debentures convertible into common stocks, the following factors should be considered:

- Quality and depth of management of the company.
- Financial condition and position of the company in its industry.
- Quality of earnings and historical growth of the company.
- Assessment of future prospects of the company in terms of sales and earnings, projected price/earnings and price/dividend ratios, existing and potential competition, etc., based on comparisons with peer companies in the same industry.
- Anticipated availability of raw materials to sustain future growth.
- Anticipated legislation, potential governmental intervention, and labor unrest.
- Trend of per capita use of the company's products.
- Demonstrated ability of the company to develop new products and/or upgrade existing ones.
- Marketing capabilities of the company.
- Ability of the market to absorb sales of securities, i.e., whether the security is traded in a "thin" market, as is the case with many insurance and bank stocks, and municipal bonds.
- Company accounting methods.
- Litigation pending against the company.

Most of those considerations are more easily researched for "seasoned" corporations than for new issues offered to the public.

Quality, overall market conditions, price performance of individual securities, industries and investment markets can be monitored by using fundamental and technical analyses. Fundamental analysis involves a review of current financial information, the use of specialized rating and analysis services, and a review of the overall status of the industry and the economy. Technical analysis is the study of a security's price movements and volumes traded over periods of time.

Debt securities include U.S. Treasury bills, U.S. Treasury bonds, U.S. Government agency obligations, corporate notes and bonds, and commercial paper. They may be used in conjunction with stocks to achieve desired portfolio balance, diversification and income objectives.

U.S. Government and agency obligations offer several advantages to the investor:

- Quality and security.
- Stability of income and marketability.
- The elimination of market and business risk.
- A sophisticated financial manager can improve yields substantially by trading and playing the pattern of rates when possible.

Corporate bonds are senior in liquidation to preferred and common stocks and, as with their investment quality, debt securities generally are characterized by stability and regularity of income. They are issued for different time periods; usually broken down into short term (under five years), medium term (five to ten years), and long term (over ten years). The portfolios of individual trust accounts and income oriented common trust funds may use a mix of bond maturities to achieve investment goals.

Commercial paper of large business corporations provides shorter maturities and competitive alternatives to short term Treasury bills. They are issued for periods of 60 to 180 days and are useful when short term yields are high and significant uncertainty prevails in the stock market. Commercial paper is useful for investing temporary funds for the short term. Care should be taken to invest only in commercial paper issued by reputable creditworthy corporations.

When making investment decisions involving debt securities, the following factors should be considered:

- Ability of the borrower to repay.
- Ratings by financial services.
- Prevailing interest rates.
- Maturities.
- Yield to maturity.
- Earning power and income projections of the issuer.
- Earnings coverage of interest and fixed charges, such as lease obligations.
- Marketability of the issue.

When making investment decisions involving rated and non-rated corporate debt securities, the following additional factors should be considered:

- Quality and depth of management.

- Adequacy of capitalization.
- Capital expenditures and the cyclical nature of the industry.

When making investment decisions involving debt securities of public utilities, the following factors should also be taken into account:

- Probability that regulatory bodies will grant utilities rate increases.
- Probability of increased output as a result of factors affecting demand.
- Cyclical nature of dominant local industries and the resulting effect on consumption.
- Effect of increased fuel costs.

Some trust beneficiaries may require tax-free income. Income from state and municipal bonds to date has been exempt from Federal income taxes, so persons and corporations in high-income tax brackets have found those types of bonds attractive for investment. Even though the rates of interest and yields on state and municipal bonds have been lower than those of U.S. Government securities, they offer a much higher yield after taxes.

There are two basic types of state and municipal bonds: general obligation bonds and revenue bonds.

General obligation bonds are backed by the total taxing power of the issuer while revenue bonds are backed by specific revenues, usually those derived from facilities constructed with the proceeds of such bond issues. The quality of revenue bonds depends on the profitability of facilities whose revenues are pledged to support them.

When making investment decisions involving rated and non-rated general obligation municipal securities, the following factors should be considered:

- Power of the taxing authority to levy sufficient taxes to cover debt service.
- Sufficiency of tax revenues.
- Relationship of debt burden to property valuations.
- Reasonableness of per capita debt burden.
- Sinking fund provisions.
- Historical trend of debt.
- Assessed property valuations, including basis of assessment.
- Relationship of tax burden to property valuations.
- Requirement of balanced budget.
- Recent budget deficit or surplus trends.
- Cash flow requirements.
- Accuracy of estimates of revenues and expenses.
- Accounting practices.
- Projected growth of tax base.

When making investment decisions involving other types of rated and non-rated municipal securities, the following factors should be considered:

1. For special revenue issues:
    - Covenants by the issuing entity regarding debt service coverage.
    - Sufficiency of tax collections.
    - Restrictions on issuance of additional bonds.
    - Default remedies.
2. For securities issued pursuant to the Industrial Development Act:
    - Sufficiency of rental revenue.
    - Advice of counsel concerning the terms of leases.
    - Lessee's financial reputation and condition.
    - Convertibility of physical facilities to other uses.
    - Ratings of lessee's senior debt securities and equity.
    - Default remedies.

A trustee should establish procedures for reviewing securities and documenting decisions regarding purchase, sale or retention which are adequate to ensure effective implementation of established investment policy. The trustee may develop "approved" or "guidance" lists to facilitate daily investment activity. Such lists should be closely monitored by the fiduciary investment or other appropriate committee, with recommendations for changes in the lists brought before the committee for review and approval. Policies should specify the authority of investment personnel to deviate from such established lists between routinely scheduled committee meetings. Efforts should be made whenever possible to reduce small holdings of securities which are not actively followed by investment personnel.

Reviews of all securities must be prepared by appropriate personnel or committees. AITDA should be required to review all securities, by issuer, annually.

Such a review must include consideration of financial and other data relevant to the company's position within the industry. The industry itself must also be analyzed. Adequate documentation must be maintained evidencing reviews performed and conclusions reached.

Adequate information must be on file to support fiduciary investment decisions. The trustee must maintain investment files for each fiduciary account which are adequate to support and document investment decisions and monitor current investments held. The trustee must retain pertinent financial and research information for all major holdings, including industry and economic research and analysis. Relevant material from investment services used by the trustee should be included.

Generally, the procedures and internal controls, regarding the purchase, retention and sale of marketable securities should be responsive to the following criteria:

1. Are investment policies and practices approved by the board of directors?

2. Are investment decisions made for accounts where the fiduciary has investment responsibility based upon:

- Research and analysis, either performed in-house or acquired from external sources?
- Ratings by acceptable financial rating services, such as Moody's or Standard & Poor's, and the evaluation of relevant factors pertaining to the type of security under consideration?

3. In making investment decisions pertaining to marketable securities, are the fiduciary's considerations:

1. Adequate for those types of investments?
2. Sufficiently comprehensive and appropriately documented?

4. Does the institution purchase and retain securities that are suitable for accounts for which it has investment responsibilities?

5. Does the institution have a policy of establishing lists of securities approved for:

- Purchase?
- Retention?
- Sale or source of funds?

6. If the answer to any part of question five is "yes," complete the following:

- Is it policy that all recommendations for additions to or deletions from such lists be reviewed and approved by a committee or an authorized person?
- Are purchases and sales of securities monitored for compliance with the approved lists?
- Are periodic reviews made of the lists of securities approved for purchase, retention or sale (or conversion of convertible securities) to assess the current appropriateness of the investments listed?

7. Has the institution established policies and procedures to review annually securities by issuer?

8. Are investment decisions concerning holdings of securities held in a relatively small number of accounts, or holdings that are too small in value to be reviewed by investment analysts, made by a responsible party and approved by a committee or authorized person?

9. Is the foregoing information considered an adequate basis for evaluating the fiduciary's policies, procedures and internal controls in that there are no significant additional factors or other circumstances that impair any controls or mitigate any weaknesses indicated above?

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## INVESTMENTS -- CLOSELY HELD COMPANIES

A closely held company may be defined broadly as one in which there are only a few shareholders, whose shares are not publicly held and, therefore, not traded on any of the securities exchanges. A significant characteristic of closely held companies is that the owners and management often are the same persons. For purposes of the examination, the administration of closely held companies held in fiduciary accounts has been expanded to include sole proprietorships and partnerships.

There are a number of complex issues associated with the administration of closely held companies. The trustee must be guided by well-developed policies and procedures to ensure sound and prudent administration and to serve as a safeguard against exposure to potential liability. The trustee should have sufficient skills, either in-house or through the use of outside experts, to properly administer those assets. The bank, in its capacity as trustee, may be held liable for any losses suffered by beneficiaries resulting from the maladministration of a closely held company. The governing instrument for the trust should have specific language regarding the trustee's responsibilities and powers for the continued operation of the company.

The trustee must first acquire a complete understanding of the company. This may be achieved by conducting a comprehensive analysis of its financial and operating records, management, products and services, the industry in which it competes, its market position, and future prospects. The governing instrument often contains specific language regarding the disposition of the business. If the instrument is silent in this regard, the trustee must act in the best interest of the beneficiaries and determine whether to continue to operate the company or to dispose of it by sale or liquidation.

If the trustee is the sole or majority shareholder, management of the company may be readily controlled. However, if only a minority interest in the company is held, the trustee may be confronted with an array of problems. Aligning with other minority shareholders may enable the trustee to influence the management of the company in the best interest of the trust's beneficiaries.

Shared responsibilities with other co-fiduciaries also present problems to be considered by the trustee prior, if possible, to accepting the account. Co-fiduciaries who are cooperative and knowledgeable about the management and operation of the company can be of great assistance to the trustee. However, an unknowledgeable or hostile co-fiduciary may place additional burdens on the trustee or cause the administration of the closely held company to be impractical.

Closely held companies must be analyzed promptly to determine the trustee’s interests therein and the appropriate courses of action to be followed. The trustee should consider:

- Financial condition.
- Management.
- Earnings.
- Growth.
- Marketability.

- Product lines or services.
- Competition.

The trustee is exposed to potential liability when the trustee, as fiduciary, undertakes the administration of closely held companies. The trustee always must deal with closely held companies at arm's length to avoid any conflict of interest or self-dealing transactions. It must consider possible interlocks resulting from common directorates. AITDA's directors and officers should not acquire an interest in closely held companies under administration.

The best interests of the beneficiaries may be served by having an officer on the board of directors of a closely held company. In such cases, insurance should be obtained to protect against any liability resulting from the board's actions. Fees received by officers while acting as directors of closely held companies should be remitted to the account. The fee may be retained by the trustee if specifically authorized by the governing instrument, court order or written consent of the beneficiaries.

The institution's policies, procedures, and internal controls for the administration of closely-held companies should address the following criteria and be responsive to the following questions.

1. When making decisions about the retention, sale, redemption or liquidation of investments in closely held companies, does the fiduciary analyze financial data and background information for each company?

2. Do the policies provide for:

- Attending stockholders' meetings of companies, particularly of those having problems?
- Exercising control over the management of companies, in which it has sole or majority voting control?
- Ascertaining the ownership of other interests, if the fiduciary holds a minority interest, in an effort to effect joint control over management of the company for the best interests of beneficiaries?
- Considering the best interests of income beneficiaries and remaindermen when purchasing or retaining closely-held companies?
- Encouraging incorporation of general partnerships and proprietorships, where feasible?
- Attempting to sell the business as a going concern, when it is considered to be in the best interest of beneficiaries?

3. In the administration of closely-held companies, does the institution consider:

- Restricting to an arm's-length basis transactions between the bank or its affiliates and a closely held company?

- Interlocks or other relationships between the company, the fiduciary and its affiliates, and personnel?
- Adequacy of company insurance programs?

4. For defunct companies, does the fiduciary have a policy to obtain certification from the Secretary of State of the state of incorporation or the Tribe, if appropriate, that a company's charter has been surrendered or information from recognized publishing services pertaining to worthless securities?

5. Does the fiduciary retain and administer investments in closely-held companies pursuant to:

- Terms of governing instruments or in accordance with local law?
- Indemnification agreements with parties at interest?
- Appropriate court orders?

6. When fiduciary personnel represent the interests of beneficiaries and the fiduciary on the board of directors of a closely-held company, does the fiduciary consider the prudence of:

- Protecting them from liability for their actions as directors by maintaining appropriate insurance coverage?
- Barring them from receiving a directors' fee or other compensation from the company for their personal benefit?
- Prohibiting them from acquiring an interest, financial or otherwise, in the company other than representing the beneficiaries and the fiduciary?

7. Is the foregoing information considered an adequate basis for evaluating the policies, procedures and internal controls in that there are no significant additional factors or circumstances that impair any controls or mitigate any weaknesses indicated above?

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## INVESTMENTS--REAL ESTATE LOANS

Real estate loans discussed in this section include mortgages, purchase money mortgages, real estate notes secured by deeds of trust, and contracts of sale.

Some investment managers use real estate loans when their market rates are attractive to increase portfolio yields. Those investments are normally large commercial real estate projects or developments.

Real estate loans have both positive and negative investment characteristics. They generally have higher yields than short term debt securities. When properly made, they are considered relatively safe investments because of the collateral protection. However, individual real estate loans usually are not readily marketable. Generally, they require large amounts of capital outlay in comparison to other investments, which may result in problems of asset concentration in smaller trust accounts.

When making investment decisions concerning real estate loans, the trustee should consider:

- Real estate values based on current appraisals by competent appraisers.
- Acceptable ratio of loan to current appraised value of the real property.
- Borrower's ability to pay.
- Documentation necessary to establish priority of lien and validity of loan.
- Adequacy of insurance on the underlying property and proper loss-payee clause.
- Adequacy of rates of interest charged.

The fiduciary department should have written policies and procedures that address the administration and supervision of delinquent real estate loans. Such policies and procedures should encompass:

- Approval process for partial releases of real estate security.
- Periodic reporting of delinquencies to appropriate committees.
- Inspections of property to forestall deterioration of the premises and preserve sale value and marketability if foreclosure appears necessary.
- Verification of adequate insurance coverage.
- Establishment of a foreclosure plan.

The fiduciary department may have a program for investing in participation mortgages. Those mortgages may be administered externally as in the case of GNMA mortgage-backed pass- throughs. Participation mortgage investments enable the trustee to maintain portfolio diversity and reduce administrative costs. The individual account and aggregate interest in those investments should be properly controlled. In the event of default, the trustee should determine that the participation agreements provide that each account bears only its pro rata share of loss.

Internal controls and a tickler system should be established to supervise real estate loans. Proper supervision requires detailed knowledge of the characteristics of each loan. Dates for periodic activities, i.e., loan payments, taxes, insurance premium payments, and other important events should be in the tickler system.

The fiduciary’s policies, procedures, and internal controls for the purchase, sale and administration of real estate loans should address the following criteria and be responsive to the questions:

1. When making investment decisions about real estate loans, does the bank consider:

- Real estate values based on appraisals by competent appraisers?
- Prudent ratio of loan to appraised value of real estate security?
- Borrower's ability to pay?

- Compliance with law and regulation?
- Documentation necessary to establish priority of lien, and legality and validity of loan?
- Appropriateness of types and amounts of insurance?
- Adequacy of interest rates charged?

2. Are real estate loans approved by the board of directors, a committee or a qualified and/or authorized individual?

3. Is it policy to require that current real estate appraisals be obtained upon extension of maturity or other modifications of such loans?

4. Do procedures require that the condition of the underlying real property securing delinquent loans be determined at least periodically?

5. Prior to granting a loan secured by real estate in another state, does the fiduciary determine that it, as fiduciary, can enforce foreclosure?

6. Is it policy to require that partial releases of real estate security receive the approval of the board of directors, a committee, or authorized person?

7. For participation mortgages, does the fiduciary:

- Keep records of the aggregate outstanding balance of loans held by all participants as well as the amount allocated to each participating account?
- Ascertain that participation agreements, entered into by the institution, provide that each account bears only its pro-rata share of loss, in the event of default?

8. If loan servicing agents are employed, does the institution ascertain that agency agreements include:

- Duties and responsibilities of the servicing agent?
- Procedures to be used for verification of assets and supporting loan documentation?
- Settlement dates for remittance by agent to the fiduciary?

9. Does the institution employ the following procedures for past due loans:

- A follow-up program for collection?
- Periodic reporting of delinquencies to the board of directors or a committee?
- Inspecting the property periodically to maintain its marketability and prevent its deterioration?
- Observing the statute of limitations to preserve collectability?

10. Do the procedures provide for monitoring the following by reference to checklists and ticklers:

- Compliance with covenants of loan agreements?
- Dates for the payment of loans, taxes and insurance premiums?

11. Is the foregoing information considered an adequate basis for evaluating the policies, procedures and internal controls in that there are no significant additional factors or circumstances that impair any controls or mitigate any weaknesses indicated above?

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## INVESTMENTS -- REAL ESTATE

Real estate represents a significant portion of the economic wealth American Indians and American Indian Tribes. The term includes real property of all kinds, including farms, timberland, mines, residences, factories, and commercial buildings. A trustee is responsible for the administration of every type of real property held in trust. The proper management of real estate demands the knowledge and skill to ensure that the property is an appropriate asset for purchase and/or retention and is, to the extent practical, productive of income.

Management should be familiar with all aspects of real property administration, including purchasing, leasing, improving, and repairing before undertaking the administration of significant holdings. Due to the variety and complexity of decisions relating to the administration of real estate, the trustee should have a separate committee to supervise real estate held in trust when significant parcels are held. A fiduciary real estate committee should establish policies and procedures appropriate for the proper administration of fiduciary real estate holdings.

The trustee should determine the condition of the title to all American Indian property under trust as soon as reasonably possible.

The trustee must have a program of appraisal and inspection of all real estate held in accounts where the trustee has investment responsibility. The appraisal program must require appraisals at least every five years for real properties held in personal trust accounts. In the case of real properties held in collective investment funds, appraisals should be performed at least annually. The inspection program must require the inspection of real properties at least as often.

The routine inspection provides the fiduciary with current knowledge of the condition of the real properties, so that informed investment decisions can be made regarding their retention and/or disposition. The inspection should be thorough enough to assure that the fiduciary is fully knowledgeable about the present condition and status of properties.

The trustee should exercise discretion in appraising and inspecting some properties. Fractional interests in real estate where the trustee has no effective control and homes or other properties occupied by beneficiaries may not often warrant appraisals and inspections.

Real estate should be retained only when appropriate for an account. When retention is determined to be the proper action, the trustee should consider the need to obtain necessary authorizations from appropriate parties. The sale of real estate should be considered when advantageous to the beneficiaries. Sales should be made only after current appraisals of properties have been performed by competent appraisers.

When making investment decisions about the purchase or management of real estate, the trustee should consider:

- Authority to purchase in the governing instrument.
- Types of accounts for which real estate may be suitable.
- Terms of leases and creditworthiness of tenants.
- Future marketability of properties.
- Assessment of risk factors, including environment liability.
- Current appraisals of properties by competent appraisers.
- Comparable sales analysis.
- Investment yields.
- Cash flow, potential for appreciation, and tax benefits.

There should be comprehensive procedures to assist management in the proper supervision of real estate holdings. The trustee must be able to monitor insurance, leases, rents, expenses, capital improvements and taxes effectively. Expenditures for routine maintenance are considered a normal operating expense. Authority to make capital improvements should reside in the governing instrument. If not, court approval and/or approval by all beneficiaries should be obtained. An effective procedure for monitoring and collecting delinquent rents should also exist.

If the fiduciary department uses real property managers, their qualifications and reputations should be reviewed closely. Property managers provide the day-to-day professional supervision of properties which are beyond the capacity of the trustee. The managing agent agreement should be reviewed by counsel if it has not been prepared by the trustee. The agreement should include provisions for the control and remittance of collected rents and the authority of the agent to incur property maintenance expenses. All property managers should be bonded.

Whenever possible, the trustee should rent property under lease agreements as opposed to monthly rentals. Lease arrangements will allow the trustee to project more reliably revenues and vacancies for a longer term.

AITDA should have separate divisions to supervise the operation and administration of agricultural and ranch properties. In such cases, if the required knowledge and skills are not available "in-house," the trustee may also consider engaging qualified outside professionals. All relationships of this nature should be entered into pursuant to carefully prepared agreements which are reviewed by counsel. Contracts with qualified tenant operators should be similarly prepared and reviewed.

Harvested crops often are stored in grain elevators or other storage warehouses until sold. The trustee should verify periodically the agricultural commodities stored in those facilities. Agricultural and ranch managers also use future and forward contracts in selling commodities. Those contracts are used to hedge the risk of selling an entire harvest at one time. The trustee should verify that proper authorization is present in the governing instrument for the use of such contracts.

***Environmental Liability***

With the enactment of the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA) and the Superfund Amendment and Reauthorization Act of 1986 (SARA), environmental liability has become a critical issue for fiduciaries. Institutions acting in their fiduciary capacities as trustees for personal trusts, estates, or as indentured trustees for bond issues may be held liable for the clean-up costs associated with contaminated property. This liability may result regardless of whether the fiduciary caused the contamination or knew of its existence at the time the account was accepted. Liability is not limited to the assets of the trust or estate. Trustee assets may be used to cover the clean-up costs if the trust account has inadequate funds.

Presently there is limited protection for fiduciaries against possible liability. However, there are a few recommended guidelines for managing trust property, which may limit the risk of liability. The following guidelines should be considered:

- Develop a policy for the management of property contaminated by hazardous waste.
- Identify potential problem real estate properties.
- Perform on-site inspections of existing property and possible new property.
- Examine the title history of the property.
- Examine regulatory agency files, i.e., EPA lists of hazardous waste sites.
- Perform an environmental audit, if concerns are noted.
- Obtain indemnification from the settlor or beneficiaries of the account.

The fiduciary’s policies, procedures and internal controls regarding the purchase, management, retention, and sale of real estate should reflect the following criteria and be responsive to the questions.

1. When making investment decisions regarding real estate, are:

- Policies and procedures adequate for the types and amounts of real estate involved?
- Forms of documentation adequate to support investment decisions?

2. Before investing in commercial properties of substantial value, does the fiduciary, in addition to obtaining current appraisals, have the properties inspected by qualified engineers and other specialists for possible structural defects?

3. Does the institution ascertain from attorneys' opinions, owners' title guaranty policies or other forms of title searches, the condition of the title to real property under administration in accounts with investment responsibility, unless it is otherwise exempt from doing so by the terms of the governing instrument, local law or parties empowered to direct?

4. Does the fiduciary have a program for appraising real estate at least every five years for properties for which the trustee has investment responsibility?

5. Is retention of real estate predicated on such considerations as:

- Provisions of the governing instrument?
- Current yield of income producing properties?
- Ease of marketability at the time of anticipated termination of the account, expected distribution, or invasion of principal?
- Other factors relevant to the retention decision?

6. Does the institution have a policy for selling real estate when advantageous to an account?

7. Does the institution have a program for keeping informed about the condition of real estate and other related factors by annual inspections or other means where an inspection is not feasible?

8. Does the institution have guidelines for selling real estate which include:

- Current appraisals by competent appraisers?
- Comparable sales analysis?
- Use of multiple listings, when appropriate?

9. Does the institution have a policy of qualifying, where possible, to do business as a fiduciary in another state for purposes of holding title to real property in that state?

10. Does the institution have procedures that provide for:

- Maintaining adequate income and expense records?
- Obtaining hazard insurance commensurate with current appraised values for insurance purposes?
- Determining that appropriate forms of insurance are in force on real properties?
- Monitoring the payment of real estate taxes to assure timely payment?
- Monitoring expenditures for maintenance and repairs?
- Monitoring capital improvements?
- Monitoring leases and rents?
- Collecting delinquent rents on a timely basis?

11. If a management agent is employed, does the agency agreement establish the agent's duties and responsibilities, frequency of reporting, and commission charges?

12. Has the agency agreement been reviewed by legal counsel?

13. Does the institution have a policy of reviewing the qualifications of real estate management agents and appraisers before employing such parties, including assessing:

- Past performance of such parties?
- Fidelity insurance maintained by agents who handle funds?

14. Except in unusual circumstances, is it the fiduciary’s practice to rent real estate on a lease basis only?

15. For the administration and operation of agricultural, ranch and other non-urban properties:

- Does the institution have a policy for using qualified personnel or independent agents to manage and/or administer the properties?
- If qualified managers have been engaged to manage properties, have the managing agreements been reviewed by counsel?
- If tenant operators are engaged to operate the properties, have operating tenant agreements been reviewed by counsel?

Primarily of an administrative nature, the institution should develop systems for loan servicing and asset management activities such as:

- Debt Collection
- File Maintenance
- Monitoring of Policies and Procedures Compliance
- Loan Workout and Collection (Development and Implementation of Strategies, etc.)
- Asset Value Preservation and Enhancement Analysis
- Asset Restructure and/or Resolution and Disposition
- The Organization’s functional management should be as follows:

Asset Management

- Strategic Business Plan preparation for each asset
- Implementation of strategy for approved Business Plan
- Restructure and workout activities
- Monitoring values, conditions, and leases
- Monitoring obligor financial condition
- Managing legal or other advisors
- Continuing financial analysis
- Individual asset reporting/action requests

Asset Disposition

- Managing/monitoring receivers
- Value enhancement/protection
- Approving budgets
- Lowering operating costs. Negotiating property sales. Monitoring property leases.

Management Information Systems

- File organization
- Maintaining files/documentation
- Monitoring documenting ticklers
- Asset data base review, input, and maintenance
- Asset Pricing Model maintenance

Operations/Accounting

- Operations management
- Financial reporting
- Compliance monitoring
- Insurance monitoring
- Servicing Agreement compliance tracking
- Fee monitoring and billings
- Budgeting and control procedures
- Preparing financial statements or other reports required by clients

In order to provide quality service, the ability to produce accurate, timely management information is fundamental, for this will be used by the clients (external and internal) in determining, in conjunction with officers, the appropriate asset management strategy, thus maximizing income. This ability is provided through the use of well developed, computer-based accounting systems, a flexible and relevant portfolio data base and comprehensive control systems with policies and procedures to assure the accuracy of the information.

Asset Accounting & Management Information Systems

Modern financial accounting systems are often modular in form with product specific software used to support each category of product separately, while at the same time allowing for integration into a common reporting module. The institution will achieve this through the use of asset and lease accountancy software packages available from the many vendors in the financial markets.

To further enhance functionality and flexibility for the needs of non-institution clients, which may have different reporting or regulatory requirements, the institution will make use of additional PC based software (spreadsheet, database, word processing, desktop publishing, etc.) to provide a comprehensive information and reporting facility.

Reporting and system needs will evolve as legal requirement or client expectations/requirements change, and controls must therefore develop to reflect these changes. It is believed a system of PC-based software, combined with the quality of staff, will enable future requirements to be identified and met in a timely manner.

Detailed Business Plans will be developed for each asset to document the strategy for maximizing income for the beneficiary, consistent with safe and sound prudential principles. For special assets, these plans will also set forth proactive management steps by the account officer to achieve workout, disposition, or return to performing status within a reasonable time period. Each action plan will incorporate a grading system to be utilized in the portfolio planning/stratification process and will address the following:

- maturity date
- valuation data
- financial strengths
- key valuation ratios (LTV, DSC) future triggers for changes in risk ratings
- documentation deficiencies
- strategy, such as amortization principal paydowns
- significant property, obligor, or market events, trends, and trigger dates
- lease expires, break clauses, rent reviews
- ground lease expirations
- detailed comparable information for future valuations
- market research and comparable information to be investigated and utilized, where available.

A Pricing Model should be developed which will be a valuable financial tool for pricing/valuation and analysis of asset portfolios. The model utilizes detailed property, financings and investment assumptions to determine portfolio value on an asset by asset basis.

The Discounted Cash Flow Models should be used for certain properties to estimate their value. The DCF projects the cash flow of a property over a holding period (generally 10-12 years) and often includes a residual property value based upon an estimated sales price at the end of the holding period. The projected income stream over the holding period is then automatically discounted back to its present value at a discount rate reflecting the risks associated with the property.

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## INVESTMENTS-- MINERAL INTERESTS

Trustees must properly manage oil, gas, and mineral properties held in trust just as they administer all other types of fiduciary assets. In most cases, oil, gas, and mineral interests held in accounts would not have been purchased by the trustee, but rather are deposited in kind. Too often, such interests are not actively monitored by the trustee until problems develop that require attention. Management must be fully familiar with those interests to be able to recognize when outside professional help is necessary. Greater activity in the administration of oil, gas and mineral interests, without a commensurate increase in expertise, exposes the fiduciary to increased liability. Establishing and following adequate policies and procedures for those assets will help to reduce exposure.

Due to the unique nature of mineral interests, the trustee may have problems properly monitoring such assets. Since valuations of the mineral interest for estate/inheritance tax and probate purposes can be difficult, the trustee may wish to employ outside consultants, such as qualified geologists, landmen engineers and tax accountants to determine the valuation and tax treatment of mineral interests held. Those considerations apply when determining the asset's ability to help meet established account objectives. Also, since mineral interests are considered illiquid and provide irregular income, it may be difficult to base income payments to beneficiaries on that type of asset.

A mineral interest may be defined as the sum of all rights to oil and gas or to solid minerals in place on a property. Owners of mineral interests have the right to enter upon the property to explore and drill for minerals. They also have the right to grant oil and gas leases and are entitled to any lease bonus, or delay rental, that may be payable in connection with the lease. Mineral interest owners also may assign all, a segregated portion, or an undivided fraction of their interest. When rights so assigned are limited in duration, they are called "term minerals," as contrasted to "perpetual minerals." The assignor of minerals can reserve to himself or herself, a portion of any lease bonus, or delay rental, arising from any future lease arrangement. This restriction to an assigned interest is described as a nonparticipating mineral.

A royalty interest may be defined as an interest in the underlying oil and gas reserves which is retained when an owner of land grants to another the right to determine the existence of commercial quantities of oil and/or gas and to develop the property and produce the mineral. For Federal income tax purposes, a royalty interest is a right to oil and gas or minerals in place that entitles the owner to a specified fraction, in kind or in value, of the total production from the property, free of the expense of development and operation. It is, therefore, a mineral interest which has been stripped of the rights and burdens of developing the property.

A working interest is a mineral interest minus the royalty interest. For Federal income tax purposes, a working interest is an interest in minerals in place that is burdened with the cost of development and operation of the property. The most generally accepted fraction of production designated to the working interest is 7/8 of the production. It might appear from the small fraction occurring to the royalty owner (i.e., 1/8), that he/she is not obtaining an equitable share of production from the property. However, it must be considered that the working interest owners bear all of the costs of developing, drilling, operating and producing the property. The costs of a dry hole are borne by the working interest owners.

A division order represents the breakdown of payments to be made once production begins. Division orders frequently contain a number of clauses that are adverse to the royalty interest owner. For example, when a lease is negotiated with an oil company for mineral interests in estates and trusts, the provision for the royalty owner to pay any treating costs to make the oil marketable should be deleted. This is a working interest expense and every effort should be made to keep the royalty interest from being encumbered with this expense. Every division order contains language which requires the royalty interest to bear its pro rata share of treating and other expenses required to make the oil marketable. If the division order is approved without amending such language, the lease has, in effect, been amended to reflect the terms of the division order.

The fiduciary administering oil, gas and mineral interests should have written policies and procedures for their proper supervision and administration. Each oil, gas and mineral interest asset should be thoroughly documented. Important elements should be monitored closely to provide assurance that no event will occur without prior knowledge of the fiduciary. A refined monitoring system should include:

- Assets to which the interest applies.
- Type of interest.
- Decimal interest owned.
- Title records.
- Account to which rent is to be credited.
- Description of property leased.
- Terms of the lease.
- Name and address of lessee.
- Expiration date of the lease.
- Amount of delay rental.
- Date rent is due.
- Bonuses.

When, under the terms of the lease, a provision is not complied with, the fiduciary should request from the lessee a recordable release of the property.

Significant costs may be incurred by the trustee in the administration of active mineral interests. The bank should take additional costs into consideration when charging fees for their administration. Such additional charges should be disclosed in the trust fee schedule for fiduciary services.

It is generally desirable to retain nonproducing mineral interests as little or no cost is involved in their retention. Appropriate retention provisions should be contained in governing instruments for accounts holding mineral interests. By keeping informed of drilling activities in those areas where mineral properties are owned, the fiduciary may have the opportunity to negotiate leases and create interest in nonproducing properties.

Generally, the institution should adopt policies and procedures which cover the following criteria and are responsive to the questions.

1. When dealing with oil, gas and mineral interests, does the institution:

1. Review trust instruments for appropriate authority to retain and administer them?
2. Gather all available information relevant to their administration?
3. Ascertain validity of title by:
    - A deed, division order or assignment?
    - An attorney's opinion?
    - Title insurance?
4. Employ personnel or outside consultants who are knowledgeable in their administration?

2. If working interests are involved, does the institution:

1. Maintain a copy of the operating agreement?
2. Analyze and approve all authorizations for expenditures?
3. Review each working interest for profitability?
4. Obtain, where necessary, adequate property and liability insurance?

3. Does the institution have an adequate accounting system for oil, gas and other mineral interests?

4. Does the institution maintain proper information systems, including:

1. Ticklers for delay rentals on non-producing interests?
2. Ticklers covering important events?
3. A list of all unleased interests?
4. Lease and royalty payments?

5. What is the institution’s policy on late delay rental and royalty payments?

6. When leasing mineral interests, does the institution utilize:

1. A special lease form prepared by the institution and/or counsel?
2. A standard industry lease form?
3. A lease form prepared by the leasing company?

7. Are all mineral lease agreements reviewed by counsel and an appropriate committee before being executed?

8. Does the institution have guidelines to avoid leasing to insiders or their related interests?

9. Does the institution utilize a specific schedule of fees for special services involving mineral interests? If so, can fees be adjusted for a percentage of income or for any extraordinary situations?

10. Does the institution have guidelines for selling mineral interests, such as:

1. Ensuring authority to sell in the governing instrument?
2. Requiring appraisals by competent, independent appraisers?

11. Does the institution have a policy of qualifying to do business as a fiduciary in another state for purposes of holding title to mineral interests in that state?

12. Does the institution have a system for filing all oil, gas, and mineral interest papers and data necessary for the maintenance of a complete historical record?

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## INVESTMENTS -- MISCELLANEOUS ASSETS

The types of assets most commonly found in fiduciary accounts are those previously discussed above. However, they are not inclusive of all forms of assets which may be encountered. Other assets are addressed herein collectively as "miscellaneous assets" because of their less frequent use as fiduciary investment vehicles. They are often received in an account as a deposit in kind. In other instances, testators, grantors, beneficiaries or other parties having power to direct the trustee may have expressed their wishes to have such investments either acquired or retained by an account. As with other fiduciary holdings, the trustee must determine that those assets are appropriate for the account and in compliance with the terms of the governing instrument and applicable laws, rulings, and regulations. As a guide, generally the policies, procedures and regulations applicable to national bank trust departments should be used as guides in developing policies and procedures for AITDA.

***Restricted Securities***

Rule 144 of the Securities and Exchange Commission (SEC) defines "restricted securities" as those acquired directly or indirectly from the issuer of the securities, or from an affiliate of the issuer, in a transaction or series of transactions not involving a public offering. The sale or offering of such securities is not covered by a registration statement filed with the SEC. "Control securities" are securities held by an affiliate regardless of how the securities are acquired. An affiliate of an issuer is a person that directly or indirectly, through one or more intermediaries, controls, or is controlled by, or is under common control with, such issuer. Control securities must be sold pursuant to Rule 144 of the SEC even if they were acquired through a public offering.

Rule 144 was adopted to provide a greater degree of certainty about the availability of the exemption from registration pursuant to Section 4(1) of the Securities Act of 1933 (1933 act) by establishing more objective standards for determining when a person may not be presumed to be an underwriter or not engaged in a distribution of securities. When adequate public financial information concerning an issuer of stock is available to the public, Rule 144 permits the public sale in ordinary trading transactions without registration under the 1933 act. Limited amounts of securities owned by persons who are controlling, controlled by or under common control with the issuer (control securities) and by persons who have acquired restricted securities of the issuer (restricted securities) may be sold pursuant to Rule 144.

Rule 144 has requirements which must be met to sell either restricted or control securities. If those conditions are met, any affiliate or other person who sells such securities should be deemed neither to be engaged in a distribution nor to be an underwriter. At the time of sale, adequate current information about the issuer of the securities should be available to the public. If the securities are restricted, the person(s) from whose account the securities are sold must have been the beneficial owner(s) of such securities for a period of at least two years prior to sale. The holding period applies to restricted securities, but not to control securities. A trust or beneficiary thereof may use the owner's original acquisition date, but only if the trust received the stock as a deposit in kind. An estate or beneficiary thereof may use the decedent's original acquisition date. If neither the estate nor the selling beneficiary thereof is an affiliate of the issuer, no holding period is required.

The number of shares of restricted or control securities that may be sold in any three-month period is limited to the greater of one percent of the class of stock outstanding or the average weekly volume of trades on all national securities exchanges over the four weeks preceding the sale. In applying that limitation, securities sold by the trustee must be combined with those sold by the settlor for his own account. The securities must be sold under Rule 144 in broker's transactions as defined in Section 4(4) of the 1933 act and paragraph (g) of the rule, or in transactions directly with a market maker as defined in Section 3(a)(38) of the Securities Exchange Act of 1934. On the day the order is placed with a broker, three copies of SEC Form 144 must be filed with the SEC unless the amount of securities sold in any three-month period does not exceed 500 shares and the sale price does not exceed $10,000. Restricted and control securities should be properly earmarked to prevent their unauthorized sale.

***Partnerships***

Partnerships may be found in all types of fiduciary accounts administered by the trustee. Partnerships often are entered into with the possibility of high investment return partially through the benefit of tax sheltered income. A partnership is generally defined as the association of two or more persons to carry on a business, as co-owners for profit. Unlike a corporation, a partnership is not an artificial person having a distinct legal existence separate from its members. Since a partnership is not a separate legal entity, the debts of the partnership are the debts of the individual partners, and any one partner may be held liable for the partnership's entire indebtedness. A partnership is not required to pay a Federal income tax although it must file an informational return each year which sets forth the income realized, whether received or not, by the partners each of whom are required to report and to pay a tax thereon.

A limited partnership is a partnership composed of one or more general partners and one or more limited partners. It differs from a general partnership in two basic respects:

* Although it comes into existence by virtue of an agreement like other partnerships, it is specifically authorized by statute.

* The liability of the limited partners for partnership debts is limited to the extent of the capital which they have contributed.

A general partnership is one in which the individual partners are each general partners whose liability for partnership indebtedness is unlimited. General partners usually are active in the management and operation of the partnership.

As a general partner, the trustee’s liability is not limited to the principal of the particular account. However, the Board of AITDA should object to a trustee investing in general partnerships, unless its liability is limited by local law. In the capacity of a limited partner, the trustee usually would have no say in the management of the assets. In the case of investment in limited partnerships, the Board should not object if such investment is authorized by the governing instrument, local law or by written consent of account beneficiaries. Of course, the limited partnership also must be a prudent investment and meet the investment objectives of the account.

***Stock Options***

Stock options are another investment vehicle that the fiduciary may use in meeting account and beneficiary needs. A stock option represents the right of an investor to buy or sell a certain number of shares of a specific stock within a stated period at a stipulated price. A call option is written by the trustee for a premium and grants the buyer the right to purchase a specified number of shares at a specified price for a given period of time. A put option is written by the trustee for a premium and allows the buyer to put (sell) the stock to the writer of the option for a specified period of time, at a specified price.

Covered call option writing is the most common strategy utilized by national bank trustees. It involves writing calls against a long position in an underlying common stock in a trust account's portfolio. The trustee is willing to forego possible appreciation in the underlying issue in return for the payment of the premium the account receives for writing the option. The amount of the premium received depends on the probabilities associated with changes in the price of the underlying stock during the period of the option.

AITDA should establish policies and procedures that should be followed by officers who engage in exchange-traded put and call option transactions for particular trust accounts.

***Mutual Fund*s**

Generally, a mutual fund is an open-end management company engaged in the business of continually issuing and offering for sale redeemable securities which represent an undivided interest in the fund's assets. In addition to a variety of shareholder services, mutual funds offer a number of advantages to the investor, whether a person or fiduciary.

Those include professional management, diversification, liquidity, and flexibility which allows investors to exchange investments among different types of funds to meet changing investment conditions.

Mutual funds may be categorized by their investment objectives: growth, income, balanced, money-market, municipal, options and various combinations thereof. In all cases when investing in mutual funds, the trust department should consider the reputation of the fund's management, the performance of the fund, and the composition of its portfolio.

Trust Banking Circular No. 4 (Revised) sets forth the OCC's position on investing in mutual funds and should be used as a guide by AITDA.

Tangibles -- Art, Coins, Bullion, Stamps, Antiques and Precious Stones

Tangible assets are usually found in estates and personal trust accounts. Generally, they are distributed to the beneficiaries at the close of the trust or estate or they may be sold to meet cash needs.

Those assets may appreciate in value at a rate greater than other investments, depending upon market conditions. Some disadvantages of investing in those assets are the lack of current income, storage and insurance costs, and the risk of purchasing counterfeit or fraudulent assets. Proper valuation of those assets is generally difficult and costly.

***Private Placements***

The Securities Act of 1933 requires that adequate and reliable information be made available about securities offered for sale to the public. The act requires registration of any security offered for sale with the SEC unless it is specifically exempted. Section 4(2) of the act exempts "transactions by an issuer not involving any public offering." This exemption has resulted in the issuance of securities through private placements to avoid registration costs and other requirements.

Securities placed privately have certain advantages for both the investor and issuer. Private placements may be used to increase portfolio yields. The investor and issuer may tailor the offering, through negotiation, to meet the needs of both parties. The issuer saves the cost of registration and obtains alternative financing. The transaction is completed without being subject to regulatory and public scrutiny.

Private placements generally are characterized by the lack of a secondary market. In the case of debt securities, the investor may be unable to liquidate the holding until maturity. Due to the small number of investors, there may be limitations on the amount of capital that may be raised by the issuer.

Non-Real-Estate Loans

The fiduciary may find it advantageous to make loans other than those secured by real estate. The following factors should be considered when making those loans:

- Acceptability and marketability of collateral.
- Collateral value to loan ratio.
- OCC registration of liens.
- Compliance with law, regulation and the terms of the governing instrument.
- Creditworthiness of the borrower and any endorsers or guarantors.
- Probability of loan collection without liquidation of collateral.
- Possibility of distributing the loan to a beneficiary if the loan is made to that party.

***Repurchase Agreements***

A repurchase agreement is the transfer of securities for a loan of funds with a simultaneous agreement to reacquire the securities at a later date. A reverse repurchase agreement is an acquisition of securities, or certain rights to securities, by an investor under a simultaneous agreement to resell the securities. Funds are conveyed to the original owner of the securities. A reverse repurchase agreement should be administered as if it were a secured loan.

A trustee must determine if the use of repurchase agreements is legally permissible before engaging in such transactions. The appropriateness of such agreements depends upon the language in the governing instrument and local law. If an employee benefit account is involved, ERISA requirements regarding prudence must be considered. In addition, the use of repurchase agreements or the strategy being implemented must be appropriate for the particular account, and the role of the proposed investment or strategy within the account's overall portfolio must be considered.

The following guidelines should be observed when using reverse repurchase agreements:

- The trust department should obtain an opinion of counsel concerning the legality of their use.
- Management must know the financial condition of parties with whom they are doing business.
- Concentrations with one firm should be avoided.
- Written agreements should be used that outline the duties and responsibilities of participants.

Additional recommended policies and procedures to be followed by trustees that purchase or sell securities subject to repurchase agreements or reverse repurchase agreements are contained in Trust Banking Circular No. 22 and should be used as a guide by AITDA.

***Forward Contracts and Financial Futures***

Before trustees engage in futures, forwards or standby contracts, it must be determined that the use of those contracts is legally permissible. The legality of those transactions depends upon the instrument establishing the fiduciary relationship and local law. In addition, the specific use of those contracts, or the specific strategy being implemented, must be appropriate for the particular account, with due consideration given to the role that the proposed investment or strategy, plays within the context of the overall portfolio.

Once it has been determined that the use of such contracts is legally permissible and appropriate for the particular account, the trustee must observe the following guidelines:

- The fiduciary should obtain an opinion of counsel concerning the legality of their use.
- The board of directors or its designee should make any decision to actually engage in such activities.
- Specific written policies and procedures should be established prior to commencing the activities.

Appropriate record keeping requirements and additional guidelines are contained in Trust Banking Circular No. 14 (Revised).

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## COLLECTIVE INVESTMENT FUNDS

Collective Investment Funds (CIFs) are designed to facilitate investment by combining fiduciary funds of various individual accounts into a single trust. Although a CIF runs counter to the accepted common law duty of the trustee not to commingle trust funds, legislation has been passed in every state authorizing trustees to establish and administer CIFs.

A CIF must be established and maintained in accordance with a written plan. The plan should be approved by a resolution of the board of directors. The board may assign authority for approving the establishment of a CIF to a designated committee.

12 CFR 9.18(b)(1) sets forth the required minimum content of the written plan establishing a CIF and should be used as a guideline by AITDA. A plan must include:

- Statement of investment powers.
- General statement of investment policy.
- Provisions for the allocation of income, profits, and losses.
- Terms and conditions governing admissions and withdrawals.
- Provisions for the auditing of bank accounts with respect to the fund.
- A basis and method for valuing assets, setting forth the specific criteria for each asset type.
- The minimum frequency for valuation of fund assets.

- The period following each valuation date during which the valuation may be made.
- The basis upon which the fund may be terminated.

A CIF is a separate entity with its own administrative requirements and tax identification number. The written plan establishing the fund is similar to a trust agreement in that it specifies the operational and administrative aspects of the fund. The accounts investing in the fund are called participants, and each participating account shares in the investment results of the fund. Exclusive management and control is in the trustee, and neither the fiduciary nor any beneficiary of a participating account has ownership of any particular asset or investment of the fund. The interests held in the fund by participating accounts are called units and represent a proportionate ownership interest in all assets held by the fund.

CIFs offer the advantage of investment diversification which is difficult, if not impossible, to achieve when investing small amounts of fiduciary funds individually. Because of the size of the transactions, it is easier for the trustee to make and supervise investments for CIFs with a resulting reduction in transaction costs and brokerage commissions.

12 CFR 9.18(a) authorizes the establishment of two basic types of CIFs, distinguished primarily by the tax status of the participating accounts. Funds maintained exclusively for investment of fiduciary funds held by the bank in its capacity as trustee, executor, administrator, guardian, and custodian under the Uniform Gift to Minors Act, are established pursuant to Section 9.18(a)(1). Funds established for profit sharing, pension, stock bonus, charitable, and other trusts which are exempt from Federal income taxation are Section 9.18(a)(2) funds.

For a CIF to maintain its tax exempt status (as distinguished from the tax status of participating accounts), it must be operated in conformity with 12 CFR 9.18 and regulations of the Internal Revenue Service. This authority derives from Section 584 of the Internal Revenue Code of 1954, which provides tax exempt status for CIFs operated by banks "exclusively for the collective investment and reinvestment of monies contributed thereto by the bank in its capacity as a trustee, executor, administrator or guardian ...." Collective funds established pursuant to either Section 9.18(a)(1) or (a)(2) may gain tax exemption from Section 584 if established in accordance with its provisions. Collective funds established pursuant to Section 9.18(a)(2) also may gain tax exempt status pursuant to the provisions of IRS Revenue Ruling 81-100. Those CIFs are called group or pooled funds. Whereas funds established under Section 584 are limited to the types of accounts specified above, the provisions of Revenue Ruling 81-100 allow the participation of agency accounts as well. The revenue ruling requires that each participating account adopt, by specific reference in its governing instrument, the terms of the CIF.

CIFs established for participation by qualified employee benefit plans are subject to ERISA. The Department of Labor has determined that investments of a CIF are also plan assets. Therefore, a trustee mismanaging fund assets could result in prohibited transactions. For example, a trustee selling assets, from the trustee to a CIF would violate Section 406 of ERISA as well as 12 CFR 9.18(b)(8) and 12 CFR 9.12. The selling of a defaulted asset to the trustee is permitted by 12 CFR 9. However, the transaction would be prohibited by ERISA, necessitating a Department of Labor exemption from the prohibited transaction rules.

***Specialized Funds***

Several specialized types of investments are permitted under 12 CFR 9.18(c). Those investment media include:

- Bank fiduciary funds established pursuant to state law.
- Variable amount note arrangements.
- A single fixed amount obligation of a single issuer.
- A fund consisting of assets contributed by a company and its subsidiaries or closely related corporations.

Variable amount note arrangements provide participating accounts with a readily accessible medium for short term investment. Cash held for fiduciary accounts may be invested on a short term basis in a variable amount note of a single borrower of prime credit. The borrower delivers the note to evidence the amount of the loan outstanding from time to time. The note may be a demand obligation or have a fixed maturity. The interest rate of the note is usually adjusted monthly based upon commercial paper rates. If the note has a demand and fixed portion, the demand portion of the note is usually referred to as the A portion and the fixed portion is known as the B portion. The A portion is variable as to the amount outstanding. The B portion requires a notice of repayment and minimum total dollar amount which must be maintained to maturity. Examiners should criticize variable amount notes when the B portion exceeds 50 percent of the principal amount of the note since such an arrangement would tend to defeat the flexibility necessary for a short term vehicle.

Trustees also are authorized to create short term investment funds (STIFs) under 12 CFR 9.18(a). 12 CFR 9.18(b) (15) codifies the requirements for the establishment and operation of a STIF. STIFs may be operated on a cost rather than a market value basis for admissions and withdrawals if the plan of operation satisfies the following:

- Investments must be limited to bonds, notes or other evidences of indebtedness which are payable on demand (including variable amount notes) or which have a maturity date not exceeding 91 days from date of purchase. However, 20 percent of the value of the fund may be invested in longer term obligations.
- The difference between the cost and anticipated principal receipt on maturity must be accrued on a straight-line basis.
- Assets of a CIF must be held to maturity under usual circumstances.

- After effecting admissions and withdrawals, not less than 20 percent of the value of the remaining assets of the fund must be composed of cash, demand obligations and assets that will mature on the fund's next business day.

***Registration Under Securities Acts***

CIFs maintained by certain types of financial institutions (banks) generally are exempt from the requirements of the Securities Act of 1933 (1933 act) and the Investment Company Act of 1940. Section 3(a)(2) of the 1933 act exempts from the registration requirements and other provisions of the act any interest or participation in any common trust fund or other similar fund maintained by a bank for the collective investment and reinvestment of assets contributed by the bank in its capacity as trustee, executor, administrator, or guardian. Section 3(a)(2) also exempts any interest or participation in a single or collective trust fund maintained by a bank for stock bonus, pension, or profit sharing plans which meet the requirements for qualification under Section 401 of the Internal Revenue Code of 1954. The exemptive provisions of Section 3(a)(2) do not cover collective investment funds which allow participation by plans covering employees, some or all of whom are employees within the meaning of Section 401(c)(1) of the Internal Revenue Code, pertaining to HR-10 (Keogh) plans. In addition, funds permitting participation by IRAs would not be exempt under Section 3(a)(2) because IRAs qualify under Section 408 of the code. Because of those anomalies in statutory provisions, Keogh accounts are offered limited exemption from SEC registration when they are collectively invested and, under current SEC rulings, IRA accounts must be registered if they are invested collectively.

SEC Rule 180 provides an exemption from registration under the 1933 act for any interest or participation by Keogh plans in a collective fund maintained by a bank. The plans must cover only employees of a single employer or employees of interrelated partnerships. The employer must be a law firm, accounting firm, investment banking firm, pension consulting firm or investment advisory firm knowledgeable and experienced in financial and business matters. The employer should be able to represent adequately its interests and those of its employees.

Keogh funds also may be commingled with corporate plan funds without corporate participations having to register under the 1933 act. The Keogh participants would have to register unless exempted by Section 3(a)(11), the intrastate exemption. Section 3(a)(11) provides an exemption from the registration requirements for any security which is part of an issue offered and sold only to persons resident within a single state or territory, where the issuer of such security is a person resident and doing business within or, if a corporation, incorporated by and doing business within, such state or territory.

For the intrastate exemption to be available, all of the interests in the fund must be sold intrastate. The commingling of intrastate Keogh plans with interstate plan assets precludes the 3(a)(11) exemption.

Section 3(c)(3) of the Investment Company Act of 1940 provides that the requirements of the act do not apply to any common trust funds or similar fund maintained by a bank for the collective investment and reinvestment of monies contributed to them by the bank in its capacity as trustee, executor, administrator or guardian. Section 3(c)(11) of the act exempts from the definition of an investment company employee's stock bonus, pension or profit sharing trusts which meet the requirements for qualification under Section 401 of the Internal Revenue Code, and any collective investment funds maintained by the bank which consist solely of such trusts. The exclusion does not include IRAs, which qualify under Section 408 of the Internal Revenue Code.

***Tax Treatment***

The income, capital gains and losses of the CIF are shared by the participants in proportion to their investment. The Internal Revenue Code and appropriate regulations treat the fund as an entity for computing gains and losses. No gain or loss is realized by the fund upon the admission or withdrawal of a participant. The capital gains or losses realized from the sale of fund investments are allocated to participating accounts as short or long term capital gains based upon the length of time the investment has been held by the fund. When a participating account is withdrawn from the fund, a gain or loss is realized, which is treated as if the participation had been sold. The result is that upon withdrawal, a participating account realizes a taxable gain equal to the unrealized appreciation or sustains a loss equal to the unrealized depreciation which accrued in the fund since the date of the account's participation.

Section 6032 of the Internal Revenue Code requires that an informational return be filed for CIFs established under Section 584 of the Internal Revenue Code. Generally, a partnership return, Form 1065, will be filed. A schedule must be filed with the return indicating each trust that has participated in a CIF during the year, and short and long term capital gains or losses allocated to participating accounts for the year.

In conducting director’s examinations, the board should be guided by the following examination objectives and criteria:

Collective Investment Funds

Examination Objectives

1. To determine if policies, procedures and internal controls are adequate for the proper administration of CIFs and that records are sufficient to reflect properly the interests of all participating accounts and the acquisition and disposition of investments.

2. To determine compliance with 12 CFR 9.18 and Comptroller's Handbook for National Trust Examiners applicable Federal and local laws governing the operation of CIFS.

3. To initiate corrective action when policies, procedures and internal controls are deficient or when violations of laws, rulings or regulations have been noted.

Collective Investment Funds

Examination Procedures

1. Complete and update the Collective Investment Fund section of the Internal Control Questionnaire.

2. Determine the scope of the examination based on the evaluation of internal controls and the work performed by internal/external auditors.

· Review any deficiencies noted in the latest report of internal/external audit and determine if correction has been accomplished.

3. Test for compliance with policies, procedures and internal controls in conjunction with performing the following examination procedures.

4. Review documentation of CIFs established or amended since the preceding examination for compliance with requirements of 12 CFR 9.18.

5. Review the quality of assets held in CIFs and determine that such assets meet the investment policies of the CIFS.

6. Inspect participants' holdings of CIF units established pursuant to section 9.18(a)(1), and ascertain whether:

- Any participant held more than ten percent of the then market value of the CIF resulting from direct investment. Any such participation should have been reduced to ten percent or less at the next valuation date.
- Any participant held more than 15 percent of the market value of the CIF resulting from other than direct investment. Any such participation in excess of 15 percent should be reduced to ten percent or less within one year.

7. Inspect investments held in 9.18(a)(1) CIFs and determine weather:

- Holding of stocks, bonds or other obligations, not guaranteed by the U.S. Government, of any one entity exceed ten percent of the then market value of the CIF as a result of direct investment. Any such holding should be reduced to the ten percent limit not later than the next valuation date.
- Holding of stocks, bonds or other obligations, not guaranteed by the U.S. Government, of any one entity exceed ten percent of the then market value of the CIF as a result of other than direct investment. Any such holding should be reduced to the ten percent limit within one year.

8. For investments by CIFs in real estate loans, determine that the bank complies with the following requirements of 12 CFR 9:

- No more than reasonable expense may be charged against the income account of the CIF.
- No more than five percent of the net income derived from mortgages held by a CIF was transferred to a reserve account during a regular account period and no transfers were made which caused the reserve account to exceed one percent of the outstanding principal amount of all mortgages held by the CIF.
- A reserve account, if established, is deducted from the assets of the CIF in determining the unit value at valuation dates.
- Accrued interest in default from mortgages is charged at valuation dates against the reserve account to the extent available, and credited to income distributed to participants. If the amount so charged is recovered, then the reserve account is credited with the interest payments received.
- The value of mortgages is determined at valuation dates on the basis of fair value as determined in good faith and, in the case of FHA and VA mortgages, at quoted market values, where available.

9. Determine that the institution, in maintaining exclusive management of the CIF, keeps records relating to investment, administrative and operational decisions.

10. Inspect participating account files to ascertain that the institution does not issue any certificate or other document evidencing a direct or indirect interest in any CIF.

11. Determine that the annual financial report of a CIF contains:

1. A list of investments as of the fiscal year end showing cost and current market value of each investment.
2. For the period since the last report, a schedule of:
    - Purchases of investments with cost.
    - Sales of investments with profit or loss and any other investment charges.
    - Income and disbursements.
3. Annotation of any investment in default, including the nature of the default.

12. If the annual financial statement includes any comparative performance statistics, are such comparisons only with general market indices?

13. Inspect reports and ascertain that the availability of the annual report is publicized solely in connection with the promotion of the bank's fiduciary services and pursuant to 12 CFR 9.18(b)(5)(iv).

14. Ascertain that variable amount notes (VANS) are:

1. Approved as an investment vehicle by an authorized committee.
2. Issued by companies which are prime credit borrowers. A prime credit borrower is one which has Commercial paper or debt obligations outstanding which are rated in one of the two highest categories by at least two nationally recognized rating services (Moody, Standard and Poor's, Fetch).

3. Maintained by the trustee on its premises, unless another location is specifically approved by the OCC.
4. Supported by full information on the capital, debt structure and financial condition of the issuer.
5. Supported by quarterly certifications from the issuing company that notes are not subordinated to any other unsecured debt of the company, that there is no pending litigation affecting such notes, and that the issuer is not in default on the payment of principal or interest on any outstanding obligations.

15. In addition, ascertain that for variable amount notes:

    1. Participation records are in balance with the amount outstanding on the note.
    2. Debit and credit entries are immediately posted to the borrower's deposit account.
    3. The institution or its affiliates do not participate in the loan for their own account.

16. Request management to justify the prudence of the following situations, if applicable:

    1. When VANs or master notes total in the aggregate in excess of ten percent of the market value of assets held by the bank's trust department, as of the previous year end.
    2. When VANs or master notes issued by a single company are in excess of five percent of the Section 508.3 market value of total trust assets as of the previous year end.
    3. When VANs or master notes have "A" and "B" components and the "E3" portion is in excess of 50 percent of the principal amount of the note.

17. Ascertain that CIFs operated pursuant to 12 CFR 9.18(c)(3) are administered so that:

    1. The total investment of the fund does not exceed $100,000.
    2. The number of participating accounts is limited to 100.
    3. No participating account has an interest in the fund over $10,000.
    4. The purpose of the fund is not to avoid the provisions of section 9.18(b).

18. Ascertain that short term investment funds are operated in accordance with the following provisions of 12 CFR 9.18(b)(15):

    1. At least 80 percent of the fund is invested in demand obligations or notes, bonds, or indebtedness maturing no longer than 91 days from date purchased.
    2. Principal is valued at cost, and the difference between cost and anticipated receipt on maturity is accrued on a straight-line basis.
    3. Assets are held until maturity under usual circumstances.
    4. After effecting admissions and withdrawals, not less than 20 percent of the value of the fund is composed of cash, demand obligations, and assets maturing on the fund's next business day.

19. Discuss with management and prepare report comments on:

1. Policy deficiencies (if considered material).
2. Internal control weaknesses (if considered material).
3. Violations of laws, rulings and regulations and the potential for surcharge.

20. Reach a conclusion regarding the quality and effectiveness of trust department management in the area.

21. Prepare a memorandum and update work programs with any information that will facilitate future examinations.

In establishing a CIF the following questions and criteria apply:

1.

1. a. Reviewed by counsel and approved by the board of directors or by a committee designated by the board?
2. Consistent with the provisions of Section 9.18(b)(1) of Regulation 9?

2. Is the composition of investments in each fund consistent with the stated investment policy?

3. To administer each collective fund in compliance with 12 CFR 9.18, do the procedures provide that:

1. Governing instruments of participating accounts are screened to verify that they do not prohibit investments in CIFS?
2. All CIFs are valued in accordance with the minimum frequency prescribed in the documents establishing the fund, or as required by regulation?
3. All valuations are completed within prescribed time periods?
4. No participation is admitted to or withdrawn from a CIF, except on the basis of the valuation and as of the valuation date?
5. No participation is admitted to or withdrawn from a CIF unless a written request for or notice of intention of taking such action was entered, on or before the valuation date, in the fiduciary records, and approved as prescribed by the board of directors?
6. No request or notice for admission or withdrawal has been canceled or countermanded after the valuation date?
7. Distributions to withdrawing participants are made in cash or ratably in kind, or partly in cash and partly in kind, provided that distributions as of any one valuation date shall be made on the same basis?
8. Overdrafts, as permitted by the regulation, are temporary?
9. The fiduciary does not sell assets to, or purchase assets from, a CIF?
10. No assets of a CIF are invested in the fiduciary’s stock or that of its affiliates, or in their obligations, including time deposits, unless the latter comprise funds awaiting investment or distribution?
11. No loans are made by the fiduciary on the security of a participation in a CIF?

12. No funds are borrowed from any source for any CIF?
13. No units of participation in any 9.18(a)(1) fund are held by an agency account?
14. All participations in 9.18(a)(2) funds by employee benefit accounts are authorized by governing instruments or directed by an empowered fiduciary other than the institution? (ERISA 408(b)(4)(B) and 29 CFR 2550.408b-4 of the Department of Labor.)
15. If the institution acquires an interest in a participation in a CIF, the participation was or will be withdrawn on the first date such withdrawal can be effected?
16. Participations in 9.18(a)(2) funds which obtain tax exemption under Section 584 of the Internal Revenue Code are limited to those accounts exempt from Federal income taxation, and trusteed by the subject institution?
17. Participations in 9.18(a)(2) funds which obtain tax exemption under Revenue Ruling 81 -1 00, as amended, are limited to qualified employee benefit accounts for which the bank acts as trustee or agent?

4. Do the fiduciary's procedures provide for the proper administration of CIFs through:

1. Properly diversifying participant holdings to avoid excess dependence on a single participating account?
2. Maintaining, in cash and readily marketable securities, such percentage of the assets of the fund as is necessary to provide for liquidity needs and to prevent inequities among withdrawing participants.

5. Does the institution have exclusive management of CIFS?

6. Does the institution refrain from issuing any certificate or other document evidencing a direct or indirect interest in any CIF?

7. Has the institution verified that the most recent audit of CIFs conforms to the requirements of section 9.18(b)(5) by determining that:

1. Such an audit has been made at least once every 12 months by auditors responsible only to the board of directors?
2. No charge is made to the CIF for such an audit, unless it is performed by independent public accountants?

8. Is a copy or notice of the availability of the financial report furnished to each person to whom a regular periodic accounting would ordinarily be rendered?

9. Does the institution file:

1. An informational tax return, as required by Section 6032 of the Internal Revenue Code?
2. A direct filing with the Department of Labor, which includes the following information: (29 CFR 2520.103-9 of the Department of Labor.)
   - Annual statement of assets and liabilities of the CIF?

- List of all plans participating in the CIF that identifies both plans and sponsors?
- The identification number(s) of the plans?

10. Do the fiduciary's practices for advertising comply with 12 CFR 9, to the extent that:

1. The availability of the annual report for funds administered pursuant to section 9.18(a)(1) is publicized solely in connection with the promotion of the fiduciary services of the fiduciary?
2. Advertisements of funds administered pursuant to Section 9.18(a)(2) do not contain any misleading statements or otherwise raise a question of violations of SEC antifraud rules?

11. Does the fiduciary comply with the requirements of Section 9.18 and applicable rulings for mortgage investments in CIFS?

12. If any investment of a CIF was segregated, do the fiduciary's procedures provide that the investment is being held solely for the ratable benefit of fund participants at the time of segregation?

13. If a defaulted fixed income obligation has been purchased by the fiduciary from a CIF for its own account, do the fiduciary's procedures provide for a determination that:

1. The cost of segregation would have been greater than the difference between its market value and its principal amount plus interest and penalty charges due?
2. The purchase was at market value or at the sum of cost, accrued unpaid interest and penalty charges, whichever was greater?

14. Does the fiduciary charge fees directly or indirectly to accounts participating in CIFs which are not in excess of the amount it would charge if the accounts were not participating?

15. When the fiduciary has established special CIFs for investments, such as covered call options, real estate, real estate mortgages, foreign securities or short term assets, do they comply with the OCC rulings and guidelines on:

1. Eligibility for participation?
2. Fund valuation?
3. Liquidity requirements?

16. When appropriate, do the procedures follow the provisions of Section 9.18(c) for investing collectively in:

1. Fiduciary funds organized and operated pursuant to local statutes authorizing the organization of such companies as in the State of New York?

2. A single real estate loan, a direct obligation of the U.S., an obligation fully guaranteed by the U.S. or in a single fixed amount security, obligation or other property, either real, personal or mixed, of a single issuer by two or more accounts?
3. A variable amount note of a borrower of prime credit on a temporary basis, participation in which is limited to accounts held by the institution as fiduciary in whatever capacity? (The fiduciary may not solicit or accept agency accounts which have been created for the sole purpose of investing in a variable amount note.)
4. A fund for investing cash balances which the institution considers individually to be too small to be invested separately to advantage?
5. Any investment specifically authorized by court order or by a governing instrument in the case of trusts created by a corporation, its subsidiaries and affiliates, or by several individual trustors who are closely related?
6. Any other manner approved by the OCC or applicable regulator?

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## PORTFOLIO MANAGEMENT

Portfolio management involves establishing and maintaining a portfolio that maximizes returns relative to an investor's ability to bear investment risk. It is an ongoing process by which an investor's objectives, constraints, and preferences are identified to develop explicit investment objectives. Market conditions, relative asset values, and the investor's circumstances are then monitored. Portfolio adjustments are made, as appropriate, in response to significant changes in any and all of the relevant variables.

The goal of the portfolio manager is to manage risk in pursuit of the determined investment objectives of individual accounts. Each account's circumstances and needs should be defined in terms of acceptable levels of risk and rate of return. The portfolio manager must try to meet the needs of the beneficiaries, considering the terms of the governing instrument, restraints of local and Federal law, and applicable rules and regulations.

In developing an investment program, the fiduciary must consider specific investment constraints as well as the overall investment objectives of an account. The following factors must be considered in determining overall portfolio strategies.

### *Investment Authority*

The fiduciary must manage investments in accordance with the terms of the governing instrument, which is the primary determinant of a fiduciary's powers and duties. The fiduciary may have sole authority in making investment decisions or joint authority with another co-fiduciary. Where required by the governing instrument, an authorized party may have to approve an investment decision or the trustee may have to consult with other designated persons. If the instrument is silent as to authorized investments, the trustee is guided by provisions of local law. The terms of the instrument may set forth various types of unusual or restrictive investment provisions, such as:

- Prohibit the purchase or sale of a particular security or one in a particular industry.
- Require the fiduciary to purchase only certain authorized securities or limit investments in one asset or asset category to a specified amount to avoid a concentration.

Whenever the corporate fiduciary's actions are contrary to provisions of the governing instrument, local law or applicable rules and regulations, it is exposed to potential liability through beneficiary litigation.

***Exercise of Reasonable Care***

The fiduciary must be able to demonstrate that it acted properly under the standard for fiduciary investments established by local law in its jurisdiction. Although standards for fiduciary investment vary from state to state (some state statutes specify "legal lists" of authorized fiduciary investments), the overwhelming majority of states have adopted some variation of the common law rule of prudence. The prudent person rule was originally stated in the Harvard College v. Amory decision and has been restated by various authoritative sources. Although language of individual state statutes vary, they follow the general theme of the prudency test as it has evolved under the common law.

Harvard College v. Amory stated the prudent man rule as follows:

All that can be required of a trustee to invest is that he shall conduct himself faithfully and exercise sound discretion. He is to observe how men of prudence, discretion and intelligence manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds considering the probable income as well as the probable safety of the capital to be invested. [Harvard College v. Amory, 9 Pick (26 Mass.), 446 (1830).]

The rule was stated later by Professor Austin Scott as follows:

The only general rule which can be laid down as to investments is that the trustee is under a duty to make such investment as a prudent man would make of his own property having primarily in view the preservation of the estate and the amount and regularity of the income to be derived. In various forms this rule has been stated in innumerable cases. It involved three elements, namely care, skill and caution. The trustee must exercise a reasonable degree of care in selecting investments. He must exercise a reasonable degree of skill in making the selection. He must, in addition, exercise the caution which a prudent man would exercise where the primary consideration is the preservation of the funds invested. (A. Scott, Law of Trusts, 3rd ed., 1967)

Employee benefit accounts are governed by the Employee Retirement Income Security Act of 1974 (ERISA). ERISA establishes a prudent person rule for employee benefit accounts, known as the Federal prudent person rule, which differs from the common law standard. The major distinguishing difference is that the prudence concept is applied to the total portfolio rather than to individual investments within the portfolio.

***Beneficiary Needs***

In structuring account portfolios, the trustee should consider carefully the personal circumstances of the beneficiaries. Once the needs of the beneficiaries are established, the trustee can establish specific portfolio objectives. The more important considerations in determining their needs are:

- Need for Income. A fiduciary must determine the amount of income that the beneficiaries need from the portfolio to maintain their desired standard of living. Often, this determination involves weighing the needs of income beneficiaries against the legitimate interest of the remainder beneficiaries in preserving and increasing the account assets. Strategy must then be formulated to produce a minimum level of income, even under adverse conditions. The fiduciary must be aware of beneficiaries' income and expenses from other sources and maintain ongoing communication with the beneficiaries.
- Need for Principal Distributions. The need or likelihood that principal distributions will be made in the future also must be considered by the portfolio manager.
- Tax Status of Beneficiaries. If the beneficiaries or the fiduciary account is in a high tax bracket, investment in tax-exempt securities, such as municipal bonds or other forms of tax-shelters, should be considered. Although tax consequences of retaining, purchasing and selling securities should not be the primary determinant for investment decisions, the ability to minimize taxes may have a significant effect on an account's total income.
- Loss of Purchasing Power. Due to inflation, the loss of purchasing power in recent years has varied from three percent to over ten percent annually. Unless a fiduciary account is established for a short period of time, the fiduciary must consider investments which will appreciate and preserve the purchasing power of fiduciary accounts.
- Human Dimension of Portfolio Management. A fiduciary must keep in mind the temperament of individual beneficiaries. Investment policy may be influenced by what individual beneficiaries want, fear and hope for. Investment objectives that the beneficiaries indicate they want to follow, may be quite different from those they are able to live with. The knowledge that the beneficiary will be disturbed by a loss in market value may be one reason for the fiduciary to minimize that risk. The extent to which investment policies should be modified by considerations relating to the temperament of the beneficiaries is a question of judgment.
- Estimated Termination Date of Account. The investment objectives established for fiduciary accounts must relate to the estimated length of time the fiduciary account will be in existence. Establishing long term investment goals for fiduciary

accounts which will terminate within a relatively short period would be inappropriate.

***Risk Management***

Over the past 30 years, the focus of fiduciary investment management has gradually shifted from a primary emphasis on individual asset selection to a more balanced emphasis on portfolio diversification and the interrelationship of individual securities, and their particular characteristics within the portfolio as a whole. Thus, the theory of structuring a portfolio has significantly altered the practice of investment management. A successful portfolio manager must structure investment portfolios which meet the investment objectives of the account while providing adequate protection against risk.

There are many different types of risks; however, for purposes of this discussion, they can be classified into three general areas: market, industry and issue.

Market risks are inherent and cannot be eliminated completely. However, they can be managed through appropriate portfolio diversification, such as multiple market portfolios. Cyclical movements in a particular market sector can be offset with investments in other markets experiencing dissimilar market fluctuations. This is an important reason behind diversifying internationally. The stock markets and currencies of different countries fluctuate, but at different times and for different reasons.

In a dynamic economy, certain industries may experience superior growth in both sales and profits while others sustain relative decline. Products of particular industries can become obsolete in the face of rapid technological development. Decisions to invest or retain investments in particular industries should be evaluated periodically in light of current industry developments and long term industry trends.

Despite the relative prosperity of a particular industry, individual companies within that industry may fail to meet anticipated investment performance. Earnings of individual companies may suffer because of internal corporate problems, such as a decline in management capabilities. In an attempt to limit the risk of a particular issue, investors may choose to concentrate on industry leaders to reduce the likelihood of serious earnings decline.

A fiduciary account should be managed continuously to achieve its established investment objectives. When individual accounts are reviewed, consideration must be given to whether securities should be retained, sold or purchased. Policies regarding portfolio composition also are influenced by the level of prices prevailing for different types of investments and the current structure of security yields. Changes in prices and yields often produce the need to change the asset mix. In a majority of portfolios, asset mix is one of the more important determinants of performance. Although many investment managers concentrate on stock selection, specific stocks held may not have nearly as much impact on total performance as will the overall level of equity commitment.

There are various investment strategies which may be used by a fiduciary. A conservative strategy is designed to minimize risk. It is intended to provide stability of income and principal, and afford as much opportunity for appreciation in principal as may be consistent with portfolio objectives. Aggressive strategies are designed primarily to provide large financial returns to the individual portfolio, either in terms of yield or in appreciation of principal. A greater degree of investment risk and wider tolerance for losses is required with that approach. Additional investment considerations which may affect the trustees selection of appropriate investment policies include:

- Safety of principal.
- Diversification.
- The generation of income.
- Capital appreciation.
- Marketability.
- Liquidity.
- Maturity in the case of debt investments.
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The trustee must have systematic procedures for identifying and meeting beneficiary needs. Beneficiaries desire the highest return possible on their portfolios. However, the pursuit for larger returns is limited by the inability of beneficiaries to tolerate the negative investment characteristics of some securities. This inability also constitutes a limit for establishing individual portfolio objectives. Portfolio policy is also a plan for the future. The analysis of investment requirements must consider probable future changes in the financial circumstances of the income beneficiaries and remaindermen.

Individual portfolio management is central to investment supervision. It is only in the context of a particular portfolio, and the realistic objectives of the particular account beneficiaries, that individual securities and specific investment decisions can be understood fully and correctly. It is in that context that fiduciaries have learned that their objective is not to manage rewards, but to control and manage risks.

Generally, the portfolio management policies should be responsive to the following questions and criteria:

1. Is it policy for management and/or senior investment personnel to review overall investment policy and potential investment problems at least annually?

2. Is it to communicate portfolio management policy to appropriate personnel by including it in committee minutes, directives, and memoranda?

3. Does the institution have an investment policy which is formulated to make the best use of quality investments in various types of accounts for which the fiduciary has investment responsibility?

4. Are the provisions of the governing instrument, local law, regulation, court order, rulings and sound fiduciary principles complied with as to:

1. Managing a portfolio?
2. Investments presently held?

5. Does the institution have a policy of diversifying investments according to:

1. Types of securities or other assets, such as common stocks, fixed income securities, real estate mortgages and real estate?
2. Types of securities according to characteristics, such as income, growth, and size of the company?
3. Types of securities according to industry and specific companies within industries?
4. Maturities of debt securities?
5. Geographic location of companies of issue, such as utilities?
6. Tax exemption of income?

6. Does the institution consider the liquidity needs of the account for anticipated distributions?

7. When deposited assets are considered unsuitable for an account, does the institution have a program of prudent and timely conversion of such assets?

8. Does the institution monitor:

1. The execution of investment decisions for purchases or sales for individual accounts?
2. The frequency of investment changes to avoid excessive trading practices?

9. Does the institution ascertain that the retention or purchase of concentrations in securities of a single entity are authorized by the terms of the governing instrument or by local law?

10. In accounts where a power holder other than the fiduciary has the authority to make investment decisions, does the institution:

1. Review the account to detect illegal, non-conforming, substandard or otherwise unsuitable investments?
2. Advise the power holder of any impropriety of an investment?
3. Inform parties-at-interest in the account if any improper investment is not disposed of and seek court relief, if necessary?
4. Resign from the account if corrective action is not taken concerning improper investments?

11. Does the institution have a policy against making improper investments for fiduciary accounts requested by a party not authorized by the terms of the governing instrument to manage or direct investments?

12. Does the institution prohibit making loans to participants in CIFs secured by units of those funds?

13. If funds are deposited in savings or time deposits at other institutions, does the institution:

1. Consider the legality and prudence of deposits which exceed deposit insurance limits?
2. Seek the highest interest rate available for such funds?

14. Does the institution review account assets in accordance with the provisions of 12 CFR 9.7:

1. Promptly upon the acceptance of each new account where the fiduciary has investment responsibility? (Promptness is determined by the nature of the assets and the time required to marshall them; however, it should not exceed 60 days, under normal circumstances.)
2. After the initial review, at least once each calendar year and within 15 months of the previous review?

15. Do minute books or other records:

1. Identify reviewed accounts?
2. Report written conclusions on the advisability of retaining or disposing of assets in the accounts?

16. Does the institution utilize account synopses and historical data in the review of account assets?

17. Does the account investment review information include:

1. Categories of investment, such as bonds and stocks?
2. Types of investments within each category, such as industry groups for stocks?
3. The amount and description of each investment?
4. Cost?
5. Market or appraised value at review date?
6. Annual income?
7. Yield at market?
8. Ratings of recognized financial service (if applicable)?

## ACCOUNT ADMINISTRATION

Fiduciary departments perform a wide variety of fiduciary services for a diverse client market, which includes persons, corporations, charitable organizations, and state and local governments. Accounts administered by a trustee are classified broadly into two types: personal trust accounts and institutional accounts. Personal trust accounts, generally administered for persons, include:

- Estates.
- Guardianships.
- Testamentary trusts.
- Inter vivos trusts.
- Agencies.

The following discussion reviews the duties and responsibilities of the fiduciary in the administration of personal accounts.

### *Court Supervised Accounts*

The administration of estates and guardianships is supervised by an appropriate court, which reviews and approves all acts of the fiduciary. Such judicial supervision is designed to protect the interests of the deceased, minors, incompetents, and unknowns.

In administering estates, the fiduciary is required to follow the instructions of the deceased's will. If the decedent did not have a will, he/she is considered to have died intestate. In that case, provisions of the probate code of the decedent's domicile govern the administration of the estate.

Letters of administration issued by the probate court are required for the trustee to commence administration of the estate. The executor acquires his/her powers, duties, and responsibilities by appointment of that court. Administration of the estate continues until a final accounting has been filed and approved, and the executor is discharged formally.

When appointed by the court, the executor assumes responsibility for safekeeping all assets of the estate. Therefore, the fiduciary must immediately identify and assume control of all assets to assure that they are adequately safeguarded and insured. In addition, the executor is required to file an inventory and appraisal with the appropriate court. The inventory and appraisal aid in establishing the value of estate assets for tax and distribution purposes.

Once the inventory and appraisal have been filed, the executor must pay all taxes, debts and administrative expenses and distribute the net estate in accordance with the terms of the will and/or local law. The executor has the power to sell assets to pay claims, taxes and administrative expenses. Depending upon local law and the terms of the will, the executor may invest assets during administration. The executor should pay all legitimate claims and expenses, as soon as they are presented for payment. Occasionally, an estate may be insolvent; that is, the claims may exceed the value of the estate. In those instances, the state's probate law will specify the priority for paying claims, administrative expenses, and support to the family during administration. After all expenses chargeable to the estate have been paid, including appropriate Federal and state taxes, the executor can begin to close the estate.

The termination of the estate requires a final accounting to the court. After the court has approved the final accounting, it will issue an order, often called the Decree of Distribution, directing the executor to distribute the net estate to the beneficiaries. The executor is responsible for delivering the assets to the beneficiaries and for properly transferring ownership. When the distribution is complete, the executor will present receipts and a supplemental final accounting to the court requesting that the estate be closed and that the executor be discharged. When the probate court finds that the supplemental final accounting and receipts from all beneficiaries are in order, it will issue an Order of Discharge.

A guardian is appointed by the court to protect the estate of a person who is mentally or physically incapacitated or who is not of legal age. A guardian may be responsible for the care of the person and their property or the court may appoint a separate guardian for both the ward's person and his/her property. A national bank trustee should normally only be appointed guardian of the property.

Under a guardianship arrangement, the ward is the beneficial owner of the property, but the guardian has certain powers derived from the court for those assets. The guardian's two main objectives in managing the protected person's property are to meet the needs of the person and conserve the assets. As the guardianship is subject to court supervision, accountings must be filed in accordance with local law.

The guardianship terminates on the death of the ward, a minor reaching legal age, or when a ward is declared competent by a court.

### *Personal Trusts*

A trust is a fiduciary relationship by which legal title to property is held by one person or corporation for the benefit of another. A trust separates the responsibility of ownership of specific property from the benefit of ownership. The person who has the responsibility of ownership is called the trustee and holds legal title to the specific property; the person who has the benefit of ownership is called the beneficiary and holds equitable title. The specific property which is the subject of this divided ownership is called the trust res or the trust property.

The two most common types of trusts administered by a financial institution are living (inter vivos) and testamentary trusts. The primary distinction between the two is the manner in which they are created. Living trusts are created by an agreement between a living person and a trustee. A testamentary trust is created by the provisions of a decedent's will after appropriate court approval is received. A probate court usually has continuing jurisdiction over a testamentary trust.

Responsibilities of a trustee include:

- Preservation of the assets composing the trust.
- Management of assets to provide income.
- Distribution of income to designated beneficiaries.
- Accounting for all actions.
- Counseling the beneficiaries.

The fiduciary's powers should be stated clearly in the trust instrument. The absence of clearly defined powers may cause uncertainty and delay, impair investment performance, and prevent the trustee from taking actions in the best interests of the beneficiaries. Local law may give the trustee certain powers to administer the trust in the absence of clearly defined instructions in the governing instrument. Common provisions within the governing instrument include the power to purchase, retain and sell fiduciary assets. Specific powers should be included for the management of real estate and other miscellaneous assets.

The instrument should provide for:

- The use of nominee names.
- Safekeeping.
- Allocation of principal and income.
- Payment of fees.
- Power of the trustee to resign, if necessary.

An inter vivos trust may be revocable or irrevocable depending upon the terms of the governing instrument. A revocable trust is one in which the settlor reserves the right to terminate the trust at any time and have the trust property transferred to his/her possession. An irrevocable trust is one in which the settlor does not reserve the right to reclaim the property. Under common law, if the instrument is silent regarding revocation, the trust is assumed to be irrevocable.

A testamentary trust is, by its nature, irrevocable, as it is created by terms of a will upon the death of a person. However, provisions of a trust agreement may designate persons with the power to terminate the trust or to appoint alternate trustees.

Termination of a trust is governed by specific provisions of the governing instrument. Several states have adopted statutes which limit the duration of trusts. In addition to state statutes, the common law rule against perpetuities should be considered when establishing a trust. The rule against perpetuities relates to the time period within which a future interest must vest.

***Agencies***

Although an agency is a fiduciary relationship that may involve the management of property for others, there are two basic distinctions between it and a trust relationship:

- The agent ordinarily is not the owner of the property for the benefit of the principal and as such, does not hold title to the property. A trustee holds title to the property for the beneficiaries.
- An agency usually is revocable at the option of the principal and is revoked by the death of either party. A trust may be irrevocable and continue beyond the death of a settlor or beneficiary.

There are several different types of agency accounts:

- Managing agency -- Generally authorizes the bank to exercise full investment discretion.
- Directed agency -- The agent acts in an advisory capacity only and executes investment changes only upon the direction of the principal.
- Safekeeping and custody -- The agent maintains custody of assets, does not act in an advisory capacity and generally does not execute investment changes for the account.

Generally, duties of the agent may include:

- Collecting the principal of matured or called bonds.
- Collecting and distributing income.
- Accepting possession of securities for safekeeping.
- Notifying customers of calls, subscription rights, defaults, etc.
- Providing periodic account statements.

Generally, the fiduciary's policies should meet the following criteria and be responsive to the following questions:

1. For personal, estates and agency accounts, does the institution obtain original or authenticated copies of:

    1. Evidence of appointment, such as trust or agency agreements, wills, letters of office from the court, or similar documentation?
    2. Evidence, such as receipts, inventories and appraisals for court accounts, or schedules of assets delivered to the fiduciary or the institution's control for the custody and protection of which it is responsible?

2. Are fiduciary accounts accepted only:

    1. With the prior written approval of the board of directors or directors, officers or committees to whom the board has assigned that responsibility?
    2. After ascertaining that:

- The governing instrument presents no present or foreseeable problems of construction?
- The account can be administered to achieve the purpose for which it was established?
- Conflicts, real or potential are identified?
- The account will be profitable?

3. Does the institution have a policy against giving assurances in connection with fiduciary activities, such as guarantees of investment quality or return from investments?

4. Before accepting an appointment as a successor fiduciary, does the institution take proper action, which is appropriately documented, to prevent the assumption of liability for acts of the predecessor fiduciary?

5. To assist it in complying with the terms of governing instruments, the purpose of the account, law, regulation and sound fiduciary and business principles, does the institution establish:

1. Checklists of data required to establish accounts?
2. Synopses of governing instruments, including investment and retention powers, income remittance, dispositive provisions, corpus invasion and other important authorizations?
3. Record of names of parties-at-interest, cofiduciaries, and statistics pertaining to appropriate parties and other historical data?
4. Tickler files or their equivalent relating to the preparation for and timely execution of future duties, such as:
    - Income remittance?
    - Principal distributions?
    - Insurance expirations?
    - Taxes due?
    - Collection of fees?
    - Receipts of dividend, interest and other income?
    - Allocation of principal and income according to local law?
    - Closing of the account?
5. Adequate controls for the recording of account liabilities?
6. Adequate filing and record keeping systems?

6. Do checklists, synopses, ticklers and similar memoranda accurately represent the powers, dispositive provisions and other conditions contained in the governing document?

7. Do the above provide the data required to administer the account?

8. Does the institution observe local law and/or terms of the governing instruments in allocating cash to income or principal?

9. Does the institution receive proper and timely written authorizations from co-fiduciaries or others whose approval or direction may be required for important actions, such as:

1. Investment decisions?
2. Distributions of principal or income?
3. Choice of legal counsel?
4. Employment of outside agents for the management of assets?
5. Payment of major expenses, fee charges, or other disbursements?

10. If the institution acts as co-fiduciary with an individual, does it supervise the accounting and management of the account?

11. If assets of a co-fiduciary account are held in safekeeping separate from the institution's vault and control, do the procedures provide that the assets are subject to the joint custody of the institution and co-fiduciary?

12. If the institution acts as co-fiduciary with another institution, does the subject institution have a policy of maintaining adequate records to protect it from a possible charge of negligence in the discharge of its fiduciary duties?

13. Does the institution file timely accountings or other advice of investment transactions and holdings with the court or others entitled thereto, such as principals of agencies, settlors, trustees, beneficiaries and other investors?

14. Do procedures provide that account ledgers indicate where assets are held if they are deposited with other banks, agents or depositories or are used as collateral for a loan?

15. In estates held open for an unusual length of time, do the policies and procedures provide for distributing as much of the assets as possible?

16. When accounts, other than estates, are terminated in whole or part, does the institution:

1. Distribute assets on a timely basis?
2. Comply with local escheat laws, where applicable?

17. With respect to the voting of proxies for stocks held in accounts for which the fiduciary has investment responsibilities, does the institution:

1. Have a written policy which outlines its position on voting proxies and the handling of social issues and other controversial matters related to it?
2. Unless the proxy was passed on to an authorized party, maintain a record of the date it was voted or the reasons for not voting it?

***Asset Quality Ratings***

All assets of significance should be assigned a quality rating based on the institution's best judgment concerning the degree of risk in the asset. In determining what assets are to be criticized, the rater must utilize mature credit judgment. No formula covers all the various types of assets, leases, contracts or credits of or made by the fiduciary.

The longer the contractual right, the greater the risk of some adverse development. Term lease and contract repayment is anchored to past performance and projections of future operations. Failure to meet projections is a credit weakness but does not necessarily mean the asset should be classified. Failure to generate sufficient cash flow to service the obligation is a well defined weakness that jeopardizes the performance of the asset or debt and, in most cases, merits classification. The extent of shortfall in the operating figures, the support afforded by assigned collateral, and/or that provided by cosigners, endorsers or guarantors should influence the severity of the criticism.

Even a lease or contract or credit that is current and supported by underlying collateral or contingent obligors may be criticized. Significant departure from the intended source of liquidation may merit criticism because repayment terms may have originally been liberal and delinquency may have been technically cured by modifications, refinancing or additional advances. Conversely, not all delinquent obligations should be classified. The original source of repayment and the obligor's ability to utilize it should be a determining factor in criticizing an asset. Undue reliance on secondary sources should be questioned for specific leases and contracts and credits and the policy permitting such a practice should be investigated. Criticized assets are categorized into the four following classifications:

- *Other Assets Especially Mentioned (OAEM).* Assets in this category are currently protected but are potentially weak. Those assets constitute an undue and unwarranted credit risk but not to the point of justifying a classification of substandard. The credit risk may be relatively minor yet constitute an unwarranted risk in light of the circumstances surrounding a specific asset. An OAEM classification should not be used as a compromise between pass and substandard.

Other assets especially mentioned have potential weaknesses which may, if not checked or corrected, weaken the asset or inadequately protect the credit position at some future date. Assets which might be detailed in this category include leases or contracts that the officer may be unable to supervise properly because of a lack of expertise, an inadequate asset agreement, the condition of and control over collateral, failure to obtain proper documentation or any other deviations from prudent practices. Economic or market conditions which may, in the future, affect the obligor may warrant mention of the asset in the institution's rating system and in the credit examination report. An adverse trend in the obligor's operations or an imbalanced position in the balance sheet which has not reached a point where the payment stream is jeopardized, may best be handled by this classification. This category should not be used to list assets which bear risks usually associated with the particular type of financing. Any type of asset, regardless of collateral, financial stability and responsibility of the obligor involves certain risks. Each asset has a certain risk, but to criticize such an asset it must be evident that the risk is increasing beyond that at which the lease or contract or credit originally would have been granted.

*Substandard Assets*. A Substandard asset is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt, lease or contract. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard assets, does not have to exist in individual assets classified substandard.

*Doubtful Assets*. An asset classified doubtful has all the weaknesses inherent in one classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is extremely high, but because of certain important and reasonably specific pending factors which may work to the advantage and strengthening of the asset, its classification as an estimated loss is deferred until its more exact status may be determined. Pending factors include proposed merger, acquisition, or liquidation procedures, capital injection, perfecting liens on additional collateral and refinancing plans.

*Loss Assets*. Assets classified loss are considered uncollectible and of such little value that their continuance as assets is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be effected in the future. Losses should be taken in the period in which they surface as uncollectible.

Generally, criticized asset write-ups are prepared to inform the Board of Directors of asset weaknesses within the institution. Write-ups should cite examples of liberal leasing and contract policies; out-of-area leases and contracts; poorly structured leases or contracts; and problem assets externally or internally identified by asset credit reviews.

When a write-up is required, the rater must present, in written form, pertinent and lucid comments relating to leases and contracts and contingent liabilities subject to criticism. A thorough understanding of all factors surrounding the asset is required, so that only those germane to the asset’s collectibility are included. Brevity must not be accomplished by failure to present adequate and pertinent information. The essential test is whether the comments support the classification.

When portions of the line of credit are assigned different classifications, or are not classified, the comments should clearly set forth the reason for such split treatment. Ineffective presentation of criticized assets weakens the value of a write-up and frequently casts doubt on the accuracy of the classification. The borrower's total outstanding liability, including contingent liability and those portions of leases or contracts or other assets in which others participate, must be listed even though only certain portions are to be criticized.

Detailed Asset Comments

A standard format for detailed asset comments should be developed. The asset write-up should consist of four distinct parts, including a heading with identifying factual problems causing the criticism. The heading should contain:

- The outstanding balance.
- The type of asset.
- The name of obligor.
- The type of business.
- The amount(s) classified.

The first part of the narrative describes the credit and summarizes the collateral package and other support for the credit. The purpose of the credit, terms, restructuring, collateral (including valuation), and line history are included in the description. Guarantors are also discussed. Other pertinent details consist of delinquency and nonaccrual status. Financial information and its significance to the obligor's financial status are covered in the second part of the narrative. Comments pertaining to key financial information should highlight credit weaknesses and support the criticism

Financial data should be included in the write-up only to exemplify the weaknesses inherent in the credit. Financial statement details and historical comparisons add confusion and detract from the write-up. The writeup should include conclusions regarding the financial information rather than force the reader to interpret the significance of statement detail.

The cause of the credit problem and its effect on sound worth and paying capacity are covered in the final part of the narrative. Economic conditions, industry problems and other external factors are stated, if required, to support the classification. Actions taken to strengthen the credit or obtain repayment are included in this section. The final part contains the justification for criticism. Reasons for split classification and explanations for portions of the credit not criticized are also appropriate. Specifics, as opposed to vague generalizations, are preferred, and truisms should be avoided. The final section should always conclude with a sentence summarizing the criticism and the reason(s) for it.

The necessity for additional comments within the loan write-up will depend on the presentation of the criticized credit. If the rater has properly conveyed sufficient information to support the classification, additional verbiage will only detract. It should be mentioned again that raters must use ingenuity, technical ability, and common sense in commenting on credits. In the final analysis, however, the essential test to determine a properly presented criticized asset is that the comments justify the classification.

# LAND RECORDS AND TITLE RECORDATION AND CERTIFICATION SYSTEM

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**Review and Analysis of Data in Land and Lease Management System and Associated Training**

Land Title and Records Offices provide a public record of the chain of title relating to real property allotted to and held in trust for individuals pursuant to various treaties with Indian Tribes and acts of Congress relating to individual Indians. The record keeping systems for LTROs include the Land Record Information System and Property Index. LRIS is an electronic information system and the Property Index is manually maintained.

Inputs are based on documents submitted by various authorities outside of LTRO for the purpose of being recorded against a property or properties. Most documents submitted for recording originate from an Agency Office or, in the case of compact agreements, Tribes.

Outputs of an LTRO generally consist of a certified Title Status Report (TSR), a certified inventory of property held by a decedent, and uncertified indications of ownership by property or by individual.

While a given LTRO may only certify properties located within the boundaries of its Area Office, uncertified ownership information may be obtained across Area Office data bases to provide an indication of ownership for an individual having trust property in multiple areas.

In comparison with public land record systems utilized under the jurisdiction of states, an LTRO combines the functions of a registrar of deeds and a title abstract company. However, the scope of an LTRO goes beyond these institutions in that an LTRO may give an opinion in the case of ownership disputes.

Ownership of land is also recorded by agencies on systems such as IRMS Ownership. A noted distinction of differences between the LTRO function and functions provided by systems such as IRMS Ownership is that the LTRO allows for public inspection of land title under certain circumstances while the IRMS Ownership information is subject to higher degrees of confidentiality.

A review of the Automated Land Management Records System was performed by the Office of the Special Trustee and the outside contractor. Based on those reviews, it appears that the ALMRS is not a replacement for LRIS but, in fact, a complementary system and an effective source for official legal descriptions of the Indian properties and related data. ALMRS is still in the development stage. Specifics regarding an implementation schedule were not yet available. ALMRS provides no ownership information and therefore cannot be used as a substitute for LRIS, which, as stated above is a workable system for the present and near term. ALMRS has limited utility in replacing the basic IRMS system which is obsolete and must be replaced.

**Gaps in the LTRO Function**

A need for improved data flow between the LTRO and the mainframe in Albuquerque was articulated by interviewees of the outside contractor. Apparently the LRIS-2 project was to correct such deficiencies but was halted in the middle of the project.

Interviews indicated that guidelines for determination of whether a document should be recorded may not be applied uniformly.

Theoretically, LRIS and IRMS Ownership records should agree as to ownership, subject only to a timing difference in a document being recorded by LRIS and posted by the Agency. In one case, LRIS reflected that an individual had an interest in only one property (tract) when the IRMS Ownership reflected that the same individual had an interest in more than 30 properties (tracts). This difference was not due to timing since the most recent document date on either system was 1992.

Field data suggest that the LTRO function is adequately supported with the current LRIS application. What is missing is sufficient training, and appraisal and probate backlogs are creating barriers to effective performance of the system. The existing appraisal and probate backlogs are exacerbated by a significant lack of qualified personnel to perform the tasks on a timely basis at all levels in the process chain. If these issues were properly addressed with additional human resources allocations, the LTRO organization could provide the information necessary to enable LRIS application to be fully effective. These findings are derived specifically from site visits to the Area Offices of Billings, Aberdeen and Anadarko. Software improvements to the LRIS system, while needed to improve the interoperability at the end-user level, should be a second priority after the re-engineering of the trust management system. Nevertheless, while not an immediate priority, the LRIS system will need upgrading in the near term. This is because each time ownership changes, the LTRO staff must perform time-consuming manual determination and documentation of ownership interests. LRIS, as designed, is not capable of performing automated chain-of-title calculations and it does not store chain-of-title or calculated ownership information. LRIS system improvements have been delayed for the past two years due to reduction in force and budget cuts. Provision for the upgrade of LRIS to LRIS-2 has been provided in the Strategic Plan over the medium term.

LTRO staff universally want more training on information systems. Some personnel are not sufficiently familiar with computers and lack on-site systems support, especially at agency and tribal locations. Some paralegal training would be helpful, especially related to probate functions. Other areas for training include real estate, accounting, property management, and appraisal, as well as a comprehensive overview of the trust process.

**Calculation of Fractional Interests**

A current system enhancement that would be beneficial would relate to the calculation of fractional interest for the heirs or beneficiaries of a deceased Indian. In the current environment, the LRIS system makes an automatic calculation of the new fractional share up to the 35 decimal places, if that is necessary. At the present time there is no such automatic calculation within the IRMS Ownership system. It is currently being done manually with some difficulty since most calculators will not go out that many decimal places. There is an impression that what staff members do is obtain the LRIS calculated fractional share and then enter that in the IRMS system. A system enhancement that would make the calculation process existing on LEIS available to the IRAS system would be desirable.

An additional suggestion was to consider the universal or global change order of interest in land and interest Indian property rights. In four current, separately-operated systems (IRAS Ownership, I'M, People and the Royalty Distribution Records System) the common identification of Indians is by their ID numbers throughout the system. The universal change order that would provide for the one-time systems input of an ID number, would go a long way in avoiding some of the problems that are currently being encountered. The current procedure and validation controls, for ID number assignment are either insufficient or need tighter management. This requires further research for clarification.

Other field comments supported the regulation on special requirements to pay owners directly for oil and gas, and mineral interest, particularly 25 CFR 162.5 Section F. Others appear to favor some methodology and procedure that would require a proof of payment to the owner so as to avoid problems in determining whether owners have been receiving the correct amount of payment or payment at all. The rate of payment from the lessee is also an issue that arises in some of these problem areas. An additional concern is when an Indian actually uses land and he is a co-owner with other Indians or non-Indians. This may arise when property is inherited and four or five siblings have an undivided interest in the property represented by their fractional share. There are specific provisions in 25 CFR 162.2 as to the ability of a co-owner to use the land himself or herself. The problem arises when one of four or five siblings uses the land for grazing, farming, etc., but does not share the profits or rewards of such usage with the other siblings.

**Summary**

***Land Titles Records Office Status:***

The priorities established by the Strategic Plan between the two major systems comprising Trust Asset and Accounting Management require that the highest priority be given to the Trust Asset and Accounting Management System. This is the logical outcome based on the findings and review of the Land Title and Records Office concluding that the present system is adequate for the near term. After that time the LTRO system will need to be upgraded and improved. However, several streamlining efforts must be undertaken in the near future in order that the LTRO is adequate for the short term.

First, the recordations that are being preformed must be streamlined and reduced to those actions that specifically impact the title or ownership. Therefore, recordation of leases must be halted. The lease will be tracked through the Trust asset and accounting management system, not through the LTRO system. Second, priorities of importance must be established in supporting other activities and reports run to support those activities. For example, Title Status Reports in support of payments at the agency must have priority as well as inventory request in support of the probate activity must have priority. Third, the backlogs of recordation must be addressed and reduced along with the problem of staff turnover. Fourth, a clean-up of the LTRO data must be implemented to identify those tracts of land that are out of unity (ownership equals 1/1) and initiate a research effort to bring unity to the tract. This research may require going back to title record 01 (original allotment) and coming forward until unity is achieved. Fifth, the probate backlogs must be addressed and resolved. The above actions except for items one and two will need to be achieved through increased funding with outside assistance or through increased fte or both. Consolidation of the LTRO offices into one needs to be analyzed as such a consolidation would have the following benefits: (1) create a nation wide LTRO function allowing duplicate records to be identified and cleaned up; (2) through economy of scale provide more expertise and reduce the turnover rate; and (3) will level the workload that varies between the existing LTRO’s.

***LRIS-2 Redesign/Reimplementation:***

The redesign of LRIS called LRIS-2 needs to begin immediately in order that the new system will be operational in the third out year. The system needs to be upgraded to a more modern version and must include the ability to provide historic listing of owners at any point in time. Additionally, it must operate in the same systems architecture as the Trust Asset Management and Accounting System and of course interface with that system. Specifically, the Land Records History and Imaging System (LHIS) will be developed to automate the chain-of-title and determination process, the title document imaging and management process, and the land title status mapping process. The systems will distribute and maintain land, ownership and title document data at the agency-field office, the LTR program office, and the AITDA level. The systems would also receive and process transactions (i.e., final title document transactions for determination and certification) from the agency-field office.

The land records and title recordation and certification system will be revised and implemented according to the above concepts and will interface with all trust management systems. This will involve acquiring a new land records and title recordation and certification system, capable of instantaneous linkage with the Trust Asset and Accounting Management System.

***System Architecture:***

AITDA Data Comm Network

The AITDA network is a simple approach using the latest commercial capabilities where available. All users with access to the AITDA network will be equipped with encryption to establish data security between points. In the communications network all data will be encrypted regardless of data type when it is sent to the network All data received will automatically be decrypted upon receipt.

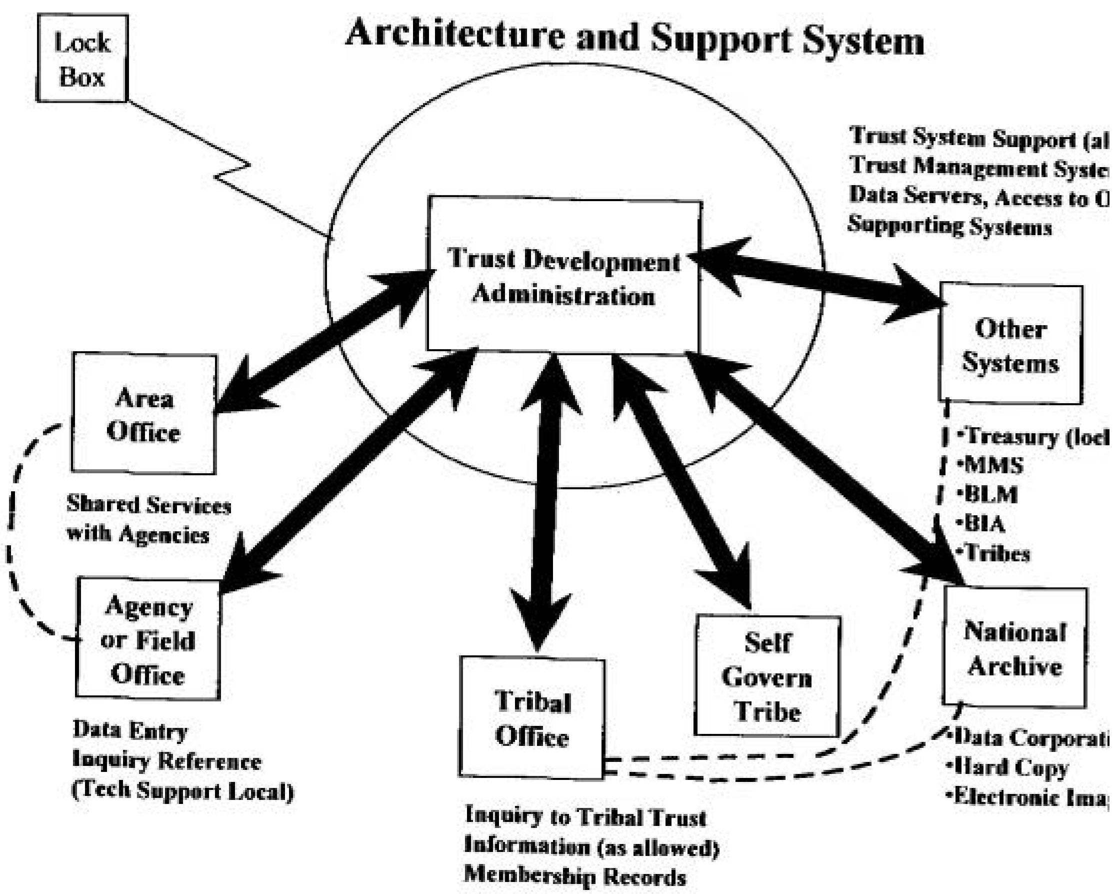
AITDA's data communication configuration should be viewed as a four part network. The first link is from the Tribes to the AITDA network switch and is a link with a capacity equivalent to a commercially available Internet link, except that the throughput will be much greater because competition for access time will be limited to AITDA users only. Simple 33.6 Kb data/fax modems are used at this level. Each Tribal location will have primary and secondary systems access numbers programmed into the Tribal PC communications control program.

The second part will provide service to the Field, Region, NIFRC, and AITDA-HQ users and will be the equivalent in its basic configuration to a capacity six times greater then that of the PC user at a Tribal access location. This link will have the capability of shrinking or swelling to a size like a satellite link to meet the needs of the moment. The communications capability has been raised at this level to higher capacity connections to support ETD’s volume switching capabilities. The line capabilities are provided by the communications vendor and do not affect AITDA's support budget. The alternate routing is also provided by the vendor, so that in the event of a disaster, natural or contrived, there are secondary and tertiary routes to communications nodes required.

In addition to the alternate routing, the AITDA HQ switching control center manages and routes all calls to their desired destinations. Access can be denied to unauthorized access inquiries. All calls will be documented and statistics kept as to the number of calls from and to each point, number of inquiry by type, number of responses by type, etc. The network utilization information and the access security features will provide information for management planning and performance measurement relative to the volumes of work being reported and performed.

The network's third part is the link or inter-face with other information systems and is somewhat dependent upon the installed base at BLM, MMS, and LTRO but is minimally equivalent to that of the PC lines installed at Tribal level. Like the second part, it will have the capacity to shrink and grow as operating needs dictate.

The fourth is a very high capacity link to a Commercial Service Bureau. This envisioned link will have a capacity equivalent to a commercial satellite link. All access to this information is through the AITDA-HQ switching services. The network design has mandated that all calls be monitored and controlled at that point to preserve data integrity, prevent erroneous access and manage the capability to an acceptable level of end-user service.

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**ASSUMPTIONS FOR THE LRIS CONVERSION/OWNERSHIP RECONCILIATION AND DEFECTIVE TITLE CLEAN-UP:**

Land Titles and Records Clean-up Policy. Number of Estimated Title Defects in Land Titles and Records: 4300

1. The research, review and identification of defective titles within the Land Records Information

System(LRIS) will be contracted during the fiscal 1998. Land Titles and Records will send the defective titles to the Agency for corrective action.

2. The Agency will review, research documents and take whatever corrective action may be needed to bring the title into conformity. Depending upon the complexity of the defect, the corrective action may be accomplished quickly or take several years. After corrective action has been taken by the Agency, they will return the document to the Land Titles and Records Office for recordation.

3. The Land Titles Records Office will record the necessary changes. One recordation may be required or a number of recordations may be affected depending upon how many allotments are involved in the correction.

| Strategic Plan Land Titles and Records Cost Estimates: | FY 97/98 | FY 99 | FY 00 | FY 01 | FY 97-01 |
|---|---|---|---|---|---|
| LTRO will research, review and identify all tracts with title defects. | 1,000.00 | | | | |
| LTRO will send defective titles to agency for corrective action. The first year the Agency will begin review and research of the top 25% of income producing titles, make corrective action and return to LTRO for recordation The residual 75% will be completed in FY 99, 00, 01. | 1,600.00 | 2,000.00 | 2,000.00 | 2,000.00 | |
| Total Costs | 2,600.00 | 2,000.00 | 2,000.00 | 2,000.00 | 8,600.00 |

**NOTE: This budget does not cover the costs of $13,343,400 to correct defective titles at the Muskogee Land Titles and Records Office. The Muskogee Area Office is the office of record and performs limited title functions for all Indian land of the Five Civilized Tribes. The Secretary of the Interior is vested with discretionary authority to represent Indians of the Five Civilized Tribes in the state courts of Oklahoma, in heirship matters involving restricted allotments of those Tribes, under the Acts of June 14, 1918, 40 Stat. 606, and August 4, 1947, 61 Stat. 731. The role of the Bureau of Indian Affairs is to provide information to the Solicitor's Office on inventory of trust and restricted property. Since 1947, the trial attorneys have regularly appeared to represent restricted members in trespass, quiet title, partition, guardianship, and probate actions in the state courts. This $13.3 million in clean-up cost should be allocated to the BIA's operating budget.**

**NOTE: This budget does not cover costs for Statutes of Limitations cases which is $38,500,000. This cost is to bring the cases to litigation, resolve them administratively, or reject them without merit. The Statute of Limitations cases are all claims "accruing" to any tribe, band o group of Indians on or before July 18, 1966, which have been identified by or submitted to the Secretary under the statute of Limitations Project. They are pre-1966 cases which were allowed under the Indian Claims Act of 1982, also known as 28 USC 2415 Claims. These cases are potential claims against third parties for money damages for questionable transfers and uses of Indian lands. Congress provided for a one time publication of pre-1966 claims in the Federal Register. Examples are trespass on land, recovery of damages for fire and flood, or conversion of property. This $38.5 million cost should be allocated to DOI's operating budget.**

# PROBATES

One of the objectives of the Strategic Plan is the improvement of trust management activities and programs. As discussed in Section A5, a major problem that must be overcome for the improvement and upgrade of the Land Titles and Records Offices (LTRO) and the certification process is the solving of the backlogs in probates. An integral function of probates is the determination of heirs and approval of wills of deceased Indians. Probate backlogs impede the distribution of income and any beneficial use of the land for the probable heirs.

Indian probates have increased over the years as a result of the General Allotment Act which allotted tribal lands to individual Indians in the late 1800's and early 1900's. Many of the Indians died intestate and their property descended to their heirs as undivided fractional interests in the allotment. As the years passed, fractionation has expanded to the point where there are hundreds of thousands of tiny fractional interests. This has caused a major problem in managing probates.

The three major components of the probate process are (1) at the agency where the probates are prepared, (2) the Administrative Law Judges who determine heirs and approve wills of deceased Indians, and (3) the Land Titles and Records Offices for recordation of the probates. The Land Titles and Records Offices are also tasked with providing title status reports for all title transfers and encumbrances.

First, the agency probate clerk, upon notice of death of decedent, assembles the probate data which consists of family histories, claims, wills, land inventories, provided by the Land Title and Records Office, and submits the probate package to the Administrative Law Judge. Second, once the Administrative Law Judge receives the probate package, notices for hearing are sent to all probable heirs and interested parties; a date for the hearing is set; the hearing is held and testimonies taken, and a final determination of heirs is issued. Third, upon adjudication by the Administrative Law Judge, the probate is sent to the Land Titles and Records Office for recordation. The Land Titles and Records Offices are the office of record of all original probate records. The final result, after approved claims are paid, is the transfer of land and distribution of any income in the account to the heirs.

The three major components of the probate process are currently backlogged at (1) the agency, (2) the Administrative Law Judges, and (3) the Land Titles and Records Offices. The agencies are backlogged with 3500 pending probate cases. As a result of the reductions in force in FY 1996, a large number of the realty staff was reduced. Another factor contributing to the backlog is the placement of individuals in real estate who had no previous realty experience. The implementation of a system for tracking Indian people is needed as efforts to locate missing probable heirs hinders the submission of probates to the Administrative Law Judges. More FTE and funding are needed to alleviate the loss of experienced real estate personnel.

The Administrative Law Judges are backlogged with 3453 pending cases. The Administrative Law Judges are responsible not only for probates but all Public Law 93-638 regulation appeals and public land hearings. Consequently, probates are not always the highest priority for the Office of Hearings and Appeals. A higher priority for probates must be dedicated to resolving the probate backlogs. The Office of Hearings and Appeals reduced the number of Administrative Law Judges from 12 to 8 in FY 1996. The FTE and funding needs of the Office of Hearings and Appeals need to be increased and more judges hired. In addition, the feasibility of contracting out probates needs to be explored. If FTE and funding are provided to the Office of Hearings and Appeals, the focus of work must remain with Indian probates. The judges' current probate workload must remain the same and not be transferred to the additional personnel who will do only probates to eliminate the backlogs. The recent Supreme Court decision in Youpee vs. the Secretary of Interior will also have a tremendous impact on the Administrative Law Judges' workload.

The Land Titles and Records Offices have a backlog of 212,381 title documents to be recorded, requests for BIA Land Inventories for deceased Indians, requests for title status reports and title maps. The LTRO must prioritize and support (1) requests for title status reports for title transfers and land inventories for probates, and (2) streamline the recordation process of updating ownership in a more accurate and timely manner. Additional FTE and funding to centralize the LTRO processes are needed. Then the savings from centralization could be used to hire more people. The fractionated heirship problem will continue to drive these backlogs until this problem is addressed and resolved.

| **COSTS TO CLEAN-UP BACKLOGS:** | | | |
|---|---|---|---|
| | FY97/98 | FY99 | FY97/2001 |
| | | | |
| PROBATE CLERKS COST | $600,000.00 | $540,000.00 | $1,140,000.00 |
| | | | |
| 3500 probates @ 12 months = 292 probates a month | | | |
| Probate clerks do 10 probates a month x 12 = 120 | | | |
| 3500 probates - 120 = 30 people needed | | | |
| | | | |
| Salary: GS-7 Probate Clerk $32,944 + 4942 (EBC) = $38,000 | | | |
| $38,000 X 30 people = $1,140,000 | | | |
| | | | |
| ADMINISTRATIVE LAW JUDGES COST | $1,400,000.00 | $1,030,000.00 | $2,430,000.00 |
| | | | |
| 3453 pending probates | | | |
| ALJ does 25 probates a month x 12 = 300 probates a year | | | |
| 3453 probates @ 300 yr = 12 more judges needed | | | |
| | | | |
| Salary: $1 10,000 + 16,500 (EBC) = $126,500 | | | |
| 126,500 X 12 judges = $1,518,000 | | | |
| | | | |

| | | | |
|---|---|---|---|
| $38,000 x 12 paralegal at GS-7 = $456,000 | | | |
| | | | |
| $38,000 x 12 secretaries at GS-7 = $456,000 | | | |
| | | | |
| LAND TITLES AND RECORDS OFFICES COST* | $4,000,000.00 | $4,000,000.00 | $9,424,884.00** |
| TOTAL COSTS FOR BACKLOGS | | | $12,994,884 |

*** Source: Bureau of Indian Affairs**

| ITEM | NDOCS | WORKLOAD | COST EST. |
|---|---|---|---|
| TSR's | 18,335 | 70,131 hrs/33.7 manyears | $ 5,977,577.00 |
| Recordation | 87,718 | 61,402 hrs/29.5 manyears | $ 1,508,750.00 |
| Imaging | 79,701 | 7,890 hrs/3.8 manyears | $ 186,500.00 |
| TS Mapping | 26,627 | 142,454 hrs/68.6 manyears | $ 1,752,057.00 |
| | 212,381 | | $ 9,424,884.00 |

**** $1,424,884 is scheduled fo FY2000**

# DEDICATED TECHNOLOGY SERVICES CENTER

## SUMMARY

The Strategic Plan proposes a single organization which will assume and manage the U.S. Governments trust responsibilities to American Indians and American Indian Tribes for trust resource management, trust funds management and land title and records management (collectively, trust management activities).

There is a need for a centralized technical services center which is dedicated to trust resources, trust funds management, land ownership and records management processes. It must have the ability to provide connectivity and seamless integration between these various systems and the AITDA employee and asset owner.

## NEED FOR A CENTRALIZED TECHNICAL SERVICES CENTER

Past problems related to the delivery of technical service to end users of the current systems are due in large part to the management structure under which the services are delivered. The 12 Areas within the Bureau have been serviced in a shotgun approach in the past. A portion of the services come from Department of the Interior through the Office of Information Resource Management, part through the BIA's Operations Service Center in Albuquerque, part from the 6 Area IMC's and some from the IRMS coordinator at the Agency level. This duty has often been a collateral duty and was assumed by someone who had a rudimentary understanding of computers but who had an interest in the technology and was willing to spend the time in ferreting out solutions to problems.

The most frequently cited reason and excuse for the Federal Government's historical and continued failure to address and resolve the long-standing trust management problems is the lack of funding and staffing for the American Indian trust management programs. While most certainly the lack of financial and managerial resources is the primary causal factor for the Federal Government's failure in this regard, under no circumstances should it also serve as an acceptable excuse for the continued neglect of the Federal Government's trust responsibilities to American Indian trust beneficiaries.

Compounding the problem was the lack of specific guidance to the field or failure to enforce standards which had been set in place. Each Area was left to develop work arounds to problems they saw as unique to their Area. The result was an uncoordinated group of ad hoc routines which changed on a regular basis adding to the confusion.

The structure also results at times in trust management responsibilities of a higher order not receiving the attention and focus they deserve and/or being traded off against other Bureau priorities of a lower order, although they are often perceived to be of a higher order. The BIA offices must expend significant resources to coordinate with managers, supervisors and staff across the Bureau to obtain cooperation. Coordination and cooperation often breaks down. Field offices often manage their operations autonomously with little discipline and control being exerted or enforced at either the local, area or Washington administrative levels. Further, because the BIA is not organized and managed by function, all too often policies and procedures written for specific trust programs or functions are not universally followed because the staff that perform the activities take their direction from general managers in area or field offices, not the trust program offices. Nor can discipline, control and accountability be enforced by a good management assessment and audit system since standardized policies, procedures and practices are rare and insufficient financial and managerial resources are provided for audit and risk management of any type. For many of those years, including many years since 1990, the trust programs were seriously under staffed and under funded. The result was that the government increasingly was unable to keep pace with the rapid changes and improvements in technology, trust systems and prudential best practices taking place in the private sector trust industry. This gap continues today and will continue to increase until the reforms outlined in the Strategic Plan are funded and implemented.

The American Indian Trust Fund Reform Act of 1994 at Section 101 sets forth the foundation and vision to be achieved by the Strategic Plan:

" The Secretary's proper discharge of the trust responsibilities of the United States shall include (but are not limited to) the following:

(1) Providing adequate systems for accounting for and reporting trust fund balances.

(2) Providing adequate controls over receipts and disbursements.

(3) Providing periodic, timely reconciliation's to assure the accuracy of accounts.

(4) Determining accurate cash balances.

(5) Preparing and supplying account holders with periodic statements of their account performance and with balances of their account which shall be available on a daily basis.

(6) Establishing consistent, written policies and procedures for trust fund management and accounting.

(7) Providing adequate staffing, supervision, and training for trust fund management and accounting.

(8) Appropriately managing the natural resources located within the boundaries of Indian reservations and trust lands."

It is clear from these outlined responsibilities, that a coordinated approach from a single centralized source is the only way to achieve the intended results of the legislation. Behind each of the eight points outlined lies a system of some sort which will be used to accomplish the task. The complexity of each system will vary and so will the outputs. However, what is common to all is the need for technical support from a staff which understands the inner workings of all of the systems and how they relate.

Frequently, we strive to meet our user's needs through creative application of information resources. However, some computer systems, applications, and networks have been in service for many years. These legacy systems were originally designed to support now outdated processes or to satisfy requirements of internal rather than external customers.

Our current environment is characterized by isolated islands of information, some elements of which are collected many times, large amounts of valuable information with primitive or nonexistent access, index, and directory methods that hamper users in using this information and inconsistent programs and data entry.

The primary system currently in use for the tracking of monies owed to over 300,000 accounts has evolved throughout the years and OSC has admitted that they cannot support beyond day-to-day operations. System inadequacies cause the U.S. Government to be in breach of its basic Fiduciary responsibilities. Any enhancements to mitigate the daily increase of liabilities must be contracted and the contractor must contend with a lack of standardization that has been allowed to evolve within the computing environment of the 12 Areas. This lack of standardization leads to greater costs for programming efforts.

Technology change is happening at a faster and faster speed. The productive life cycles of technologies are getting shorter. For an organization to compete in today's environment, whether it is private or government, it is necessary to gain an advantage over the competition by the best means available. People are the life blood of any organization. The effective use of all the people in an organization determines the success or failure of the organization. The focused distribution and diffusion of technology from one centralized source is one means of helping to ensure the success of an organization's workforce.

Increased productivity through the effective use of technology has played an important role in both government and private industry. The implementation of any new or existing technology can create many opportunities for increased productivity. To take full advantage of the opportunities it is necessary for the technology to be used and understood by the largest possible segment of a work force. The process of spreading the new technology through all practical facets of the organization is known as technology diffusion. It is the dispersion of new technology through an organization which is the key to effective implementation and the necessary antecedent to any expected increases in productivity through technology.

In the future it is seen that there will be several on-line, real time systems which will track the land ownership, collection, investment, and disbursement of funds to their owners. In most cases, these systems will be leased from commercial trust vendors and will be run and maintained by the vendor. The information which will be needed by the AIDTA employee to perform basic trust operations must be readily available. In order to service the Indian customer, they will have to be able to seamlessly access and provide information from all the systems in a consolidated and meaningful format to the trust owner. The ability to react to internal and external demands for specialized reporting and presentations and provide and coordinate the delivery of information to the end user is something that would be best done from a centralized technical service center which understands the information and is able to deliver it in focused manner.

To embrace the future, we must focus on how we handle information, and how our users can obtain information and services important to them. This new focus changes our perspective of government to enabling their success and achievement, individually and collectively, through providing appropriate access to information sources and services.

Economic and cultural diversity abounds across our client base, and our users simultaneously have individual and shared needs for services.

There is a need to establish an information resources infrastructure, standards, and methodologies, and improve information accessibility and usability.

We must empower our users through direct and easy access to the specific information and services they need, allowing them to fulfill their needs and express their opinions directly, wherever they are, any time of day.

Convenient access to information and communications systems will challenge us to meet our user's needs in new ways. Interactive services and multimedia two-way communications will be available to every man, woman, and child through diverse systems installed in homes, offices, and public places. Our users of all educational levels, special needs, economic status, and ethnic groups will have access to these technologies and find them helpful and easy to use.

A well-defined set of security, data, and service interchange standards will ensure that anyone can access data or services provided electronically.

We must be able to use information technology in a way that complements commonly available user interface services such as the Internet, selectively provides required information and services directly to specific users, makes services and data available electronically in a uniform manner, while protecting the privacy of individuals and enterprises, and assuring the authenticity of information.

In order to better serve our users, it is proposed that the Division of Trust Fund Systems restructure along the following lines:

- A Branch of System Analysis and Special Projects which will include personnel to handle application development, future system's design, multi-media, and any system's analysis or special projects.

- A Branch of Application Support which will include a help desk, training/testing, trust operations systems support as well as PC based support.

- A Branch of Operations which will support telecommunications, security, LAN/WAN, and day-to-day printing requirements.

As applications of automation increase, the work of the technical services center grows more important. Complete security must be provided for all computer applications. A coordinated effort will be needed to ensure the proper controls are in place on all of the systems allowing AITDA employees and trust owners only access to what is needed to do their jobs or inquire about their individual holdings. This control is optimized from one point of delivery. Further, the point of delivery should be from a technology service center which is devoted to providing only service to the AITDA and not one which has multiple programs to support and must choose between trust related activities and non-trust related activities. A centralized technical service center will be able to expend all of its resources in the support of trust activities.

# NATIONAL ARCHIVES & RECORD CENTER

## SUMMARY

The Strategic Plan proposes the establishment of a single, centralized, state of the art archives and records management center (Center) as the official custodian of all fiduciary records created by the Department of the Interior offices and bureaus and other Federal entities such as the U.S. Treasury that support the execution of the United States' trustee responsibilities to American Indians.

As custodian the Center will perform all functions relating to the development and implementation of government-wide Indian fiduciary records management policy; identify and catalog all Indian fiduciary record types, origination points and processing paths; design, establish, maintain and provide oversight of interim and permanent physical storage facilities; package and receive the records into permanent storage; safeguard the records from loss, damage, destruction and unauthorized access at both interim and permanent storage facilities; design and implement appropriate disaster recovery protection; and provide records management training, guidance, interfaces and oversight of all offices, bureaus and organizational entities that create Indian fiduciary records in their normal course of business.

The Center will perform government-wide policy, planning, coordination, acquisition, implementation and control functions for Indian fiduciary records management systems relating to both resource management and revenue accountability. It will review the effectiveness of operations of fiduciary related records management systems; develop, in coordination with operating programs, solutions to weaknesses; and trains operating personnel in the proper use and management of the systems. The Center will develop policy for and ensure the establishment of a system of supervision, staffing, facilities and operational criteria at program offices to ensure proper identification, maintenance and protection of active program documents and the prompt and effective disposition of inactive documents from the program offices to the custodianship of the Center. The Center will ensure access to the fiduciary records by only authorized entities in an effective and efficient manner that ensures the physical protection of the records and the proprietorship of their contents. The Center will be the focal point, in regard to fiduciary records access and management, for research, audit and litigation functions and processes involving the government's fiduciary operations relating to Indian trust resources and revenues.

## NEED FOR A SINGLE CENTRALIZED ARCHIVES AND RECORDS CENTER

The problem is the nonexistence of a government-wide records management plan, organization or single physical plant to safeguard trust records.

The core problem confronting the U.S. Government in executing its fiduciary responsibilities to American Indian Tribes and individuals is the lack of an adequate records management and safekeeping system for official records created in the normal daily business cycle of managing Indian trust resources, revenues and payments. Current management policy, procedures, information resources, automated systems and related practices do not recognize the existence nor the interrelationships of the multiple governmental entities engaged in the creation and maintenance of Indian fiduciary records. This void of a government-wide Indian fiduciary records management and safekeeping system has resulted in the government's inability to provide an accounting to Indian Tribes and individuals of their trust resources that meets the standards of the American Indian Trust

Fund Management Reform Act of 1994 and the standards of ordinary prudence applicable to all trustees, public or private.

The Reform Act of 1994 requires the establishment of appropriate policies and procedures and necessary systems that will allow the United States Government to: (1) properly account for and invest, as well as maximize the return on the investment of all trust fund monies; (2) prepare accurate and timely reports to account owners and others on a periodic basis regarding all collections, disbursements, investments and return on investments related to their trust accounts; and (3) maintain complete, accurate and timely data regarding the ownership and lease of Indian lands. One of the essential ingredients to the successful accomplishment of this legal decree is the retention and safekeeping of the records that support the actions taken by the trustee in the normal business cycle of trust resource management activities.

Yet, it is a proven fact from the numerous audit and reconciliation attempts by the government, using both internal professional expertise and that of public accounting firms, that the core of the accounting, auditing and reconciliation problems associated with Indian trust funds management is the missing source documentation at all action points of the normal business cycle. Consequently, the government cannot obtain an unqualified public accounting firm audit opinion nor provide convincing documentation in lawsuits brought by Indian Tribes and individuals to prove the adequacy of the government's execution of its fiduciary accountability. Thus, at this point in time, the government cannot meet the Reform Act requirements nor the standards of prudence.

The interrelationship of the creators of Indian fiduciary records, government-wide, is not accommodated by the current records management system.

The records that support the fiduciary activities of the government are created by several organizational entities both within and external to the Department of the Interior. The BIA is not the only organizational entity involved in creating Indian fiduciary records although a major portion of the day-to-day activity is performed by BIA entities due to the fact that Indian trust resources are under the BIA's management jurisdiction. Other entities such as the MMS, the BLM and the U.S. Treasury also create many documents essential to support trust management activities. Furthermore, with the advent of Tribal operated programs through the Indian Self-Determination Act (PL 93-638) contracts and compacts under the Self Governance Act, Indian Tribes themselves are now the creator of many essential trust support documents. Although the programs are under Tribal management the fiduciary responsibility remains with the Secretary of the Interior and therefore the records created under these contracts and compacts are essential to support the government's accountability. Presently, to the detriment of the execution of the Secretary's fiduciary responsibility, each of these entities operate under their own records management policy, procedures, storage practices and records retention schedules without recognition of their interrelationship to the single responsibility of the Secretary.

***The symptoms of the problem are many.***

In this current disassociated operational environment there is no way to estimate the number of missing source documents essential to execution of the fiduciary's responsibility. However, the Tribal Trust Funds Reconciliation Project; which was completed in December 1995 and covered the period of July 1, 1972 through September 30, 1992; disclosed numerous weaknesses and deficiencies in record keeping throughout the government. The consequences of the condition of the records was the prevention of a full reconciliation. First and foremost of these weaknesses is the fact that pertinent records exist at over 130 physical records storage sites nationwide. Compounding the effects of this geographic dispersion is the lack of sound and enforced records management policy, procedures and practices.

1. Multiple Records Storage Sites: A national inventory of the trust financial and resource management source documents necessary to the execution of the Reconciliation Project agreed-upon procedures did not exist. Nor was the physical location of the documents known. This deficiency forced an extensive search effort which disclosed pertinent records located in over 130 locations nationwide under the jurisdiction of various governmental entities. This nationwide dispersion of trust records required extensive effort and cost to locate, inventory, ship and organize to ready them for the reconciliation process. Also, records pertaining to a number of Tribes were found to be located at multiple sites because of changes in the location of BIA service offices, Federal record centers and archive service centers. Trust records were found at the following locations throughout the United States:
   - 12 BIA Area Offices
   - 86 BIA Agency Offices
   - 13 Federal Records Centers
   - 15 Regional Archives
   - The Office of Trust Funds Management (Albuquerque)
   - The Division of Accounting Management (Albuquerque)
   - The GSA Indian Trust Accounting Division (Maryland)
   - The Minerals Management Service (Denver)
   - The U.S. Treasury

   It was also disclosed that the Bureau of Land Management, the U.S. Geological Survey, some Tribes and even some state historical societies and other organizations may be in the possession of trust resource management and financial records pertinent to providing a full accounting by the trustee to Indian Tribes and individuals of their trust assets.

2. Unsuitable Safekeeping Practices and Facilities: Reconciliation Project staff dispatched to record storage sites to perform inventory and shipping tasks encountered many records in jeopardy of loss or destruction due to the following:
   - Poor and inconsistent record keeping practices (Operations personnel lacking knowledge as to what records should be preserved.)
   - Unsuitable and unsafe storage facilities such as a horse barn, paint locker, sheds, attics, and garages that were rodent invested and/or toxic to human access because of hunta virus potential, asbestos, paint fumes, molds and fungus.
   - Damaged records caused by environmental conditions (floods, high humidity, extreme heat and cold, etc.)

- Unmarked and non-inventoried boxes of records.
- Forgotten storage locations and whereabouts of records (i.e., one BIA Area Office forgot the existence of one of their warehouses where records were subsequently located. Records unknown to exist pertaining to a split agency were located at the former agency.)

3. Records Management System: The Reconciliation Project surfaced a multitude of records management deficiencies throughout the government in the custodianship of Indian fiduciary records. The foremost deficiencies were the:
    - lack of a national records inventory
    - lake of a national storage facility inventory
    - lack of modern archival and retrieval systems
    - lack of an inventory of critical source document types, purposes and approval/validation criteria
    - lack of an inventory of data by form (hard copy vs electronic) and by time period
    - lack of minimum transaction documentation standards
    - lack of source document integrity
    - lack of operating personnel knowledge as to what constituted fiduciary records
    - lack of standard document work flow procedures
    - lack of uniform filing procedures
    - lack of uniform support document content
    - lack of transaction integrity
        - Co-mingling of multiple Tribes' data on a single document
        - Co-mingling Tribal and non-Tribal information on single source document
        - Co-mingling revenue from multiple sources (i.e. receipts for multiple leases summed to one amount without specifying amount received for each lease )

The adverse effects of the current condition of the government's record keeping management of Indian fiduciary records is significant.

Missing Documents: The impact of the government's record keeping practices on the Reconciliation Project was that there were 32,319 cash receipt, disbursement and internal transfer transactions; as itemized below; totaling $2.4 billion that were posted to Tribal trust fund accounts for which the supporting financial source documents were not located:

| | |
|---|---|
| Unlocated Receipts: | $1.1 billion |
| Unlocated Disbursements | .8 billion |
| Unlocated Transfers | .5 billion |
| Total | $2.4 billion |

Some offices of the Bureau of Indian Affairs sent trust land resource records to Federal records centers but did not identify them as trust records nor were they designated to be retained as permanent records. The result was that many trust records were destroyed. For example, in one sampling, ten years of timber contracts were found to have been destroyed. Generally, the "Fill the Gap" procedures of the Reconciliation Project was significantly curtailed because large numbers of leases, permits and contracts authorizing the use or extractions from Indian trust lands could not be located.

Another example of the condition of the government's record keeping of Indian fiduciary source documents is demonstrated by the fact that over $4 billion in disbursements from Tribal trust accounts were not fully documented.

Yet another example of the failure to recognize and deal with the interrelationship of the various government entities role in the United States Indian fiduciary responsibility is the custodianship of negotiated checks drawn against Indian trust fund accounts. The checks, which are under the custodianship of the U.S. Treasury, are not treated as permanent Indian records and therefore not segregated by the Treasury from checks issued against appropriated and other funds thus allowing their routine destruction by the Treasury under their records retention policies, procedures and practices. The unavailability of these records due to their destructions presents difficulties in the full and accurate reconciliation of individual Indian and Tribal accounts and consequently the discharge of the government's fiduciary responsibility to Indian Tribes and individuals. Copies of the negotiated checks, even before their retention period expires are not immediately available from Treasury for timely verification and reconciliation purposes by the Department of the Interior.

Last but not least there is not a system of redundant record keeping. Thus, no back-up exists if a record is destroyed or cannot be located for some other reason.

"None Available" is the conclusion of a search for other sources for trust records management.

BIA as the Records Manager: The BIA has a history of not being able to properly maintain its records as substantiated by the 20 year Reconciliation Project which encountered missing documents throughout the reconciliation period. Furthermore, the National Archives and Records Administration (NARA) conducted at least 3 technical evaluations of the BIA records management program. Each evaluation contained a litany of disclosures covering poor records maintenance procedures, unsuitable storage facilities and inadequate management involvement. Although there were recommendations made to correct these deficiencies, corrective actions on the part of BIA was never fully implemented.

The BIA lacks the institutional records management culture and norms to sustain an effective program. A recent example of this is the BIA Reduction In Force (RIF) effected in February 1996. In 1994, the BIA had 12 recently established area records officers and four positions at its headquarters in Washington, D.C., to operate the Bureau-wide records management program. Even at this staffing level, the BIA was unable to properly maintain its records and bring the program into compliance with

NARA technical requirements. BIA abolished all but four of the 16 records management positions in its RIF. Program needs and requirements were not considered when the positions were selected for abolishment. The four retained positions survived due to the availability of local funding or other criteria that had no relationship to records management need throughout the Bureau. The cultural deficiency is also demonstrated in the continued use by some BIA areas and agencies of the records disposition handbook published in 1977 although a new records disposition handbook was developed in 1989. More recently, a records control schedule was distributed by BIA to its operations offices but had to be withdrawn because it was developed without input from the Office of the Special Trustee for American Indians concerning fiduciary trust records. The Schedule contained temporary records retention periods for trust-related documents instead of specifying their "perpetuity" status.

Because a centralized records management facility does not exist, a coordinated effort to prevent records destruction is not possible. Proper record protection procedures are either unknown to BIA staff that create trust documents, not being followed, or not comprehensive enough to provide the requisite guidance. For example, a notice of intent to destroy trust land lease records was sent by NARA to a BIA agency. Obviously the records were not recognized as trust related when they were originally sent to NARA for storage or they would have been classified as permanent and no notice to destroy would have been required. Because the BIA agency staff was unfamiliar with the NARA form or they still did not recognize the records as fiduciary in nature, no response was provided by BIA regarding the final disposition of the records. As a result, the records were destroyed by NARA. This is a recurring situation, even today, in efforts to define and place a freeze on Indian fiduciary records.

The BIA stores records in various locations and facilities that are unsuitable and unsecured. Records are stored in areas that are not only damaging to the records but also hazardous to the health of staff because of possible disease from the dirt, water, mold, rodent excrement, asbestos and other hazards.

NARA as the Records Manager: Although the NARA has the technical expertise in records storage it does not have the specialization fiduciary mission knowledge required to meet the government's fiduciary responsibility for Indian trust resources. NARA serves a generalist function in that it accepts records for archive (permanent retention) purposes primarily on what the originating agency identifies as the content and retention period. It processes a record for permanent retention or disposal on the basis of the originating agency's designation as to the records historical, legal, financial and administrative value and the originating agency's designated retention period. If the originating agency does not perform an adequate job of defining the records to NARA, as we know BIA has not done in the past nor currently, the records can receive a misclassification as temporary and upon expiration of the originating agency's defined retention period, vital records to maintaining Tribal and individual Indian trust relationships are destroyed by NARA. It is imperative that all trust records be protected from destruction, especially in light of the current litigation environment. This job is not being accomplished.

Some other problems exist with NARA as the safe keeper of trust records.

NARA does not have the knowledge as to what constitutes a trust record. NARA staff maintains records according to series descriptions provided by the records originating agency and is, therefore, not familiar with the source documents contained in a case file. In other words, they take for face value the importance of a record as determined by the record originating agency. The Office of the Special Trustee for American Indians proposes to assemble a staff of professionals knowledgeable of the specific types of trust records that are generated from each program and with the dedication and know how for perpetual preservation of the records.

NARA does not have a single center for Indian trust records. The current decentralization of trust records in NARA facilities is inefficient and not cost effective. Indian trust records are stored in 13 Federal Records Centers (FRC) and 15 Regional Archives, which are at locations different from the users. This makes records retrieval difficult because records for the same Tribe or groups of individual Indians are sometimes stored at multiple locations requiring a search at all NARA sites to determine the universe of available records. Also, travel to the multiple NARA sites that may be involved in a given research task for lawsuits and audits becomes a major expense. The centralization and consolidation of records in one center will significantly reduce these costs.

Storage of records by NARA must be funded by agency appropriation for payment to NARA. Since specific records storage funding must now be obtained by each agency the funding process is in place to store the records in a single central location that is cost-effective and convenient for the government and Tribes.

Records management and storage training that is provided by NARA is not trust-specific. NARA does not know the trust program functions and/or its documents. Only experienced Indian trust fiduciary records management staff as proposed by this Strategic Plan can provide such training to the creators of the source document. Neither does NARA have knowledge of the interrelationship between originators of trust source documents. Trust records from agencies other than BIA are not addressed as part of NARA's records management processes and unless these other agencies designate the records as permanent, which they do not, then the records can and are destroyed. Also, because NARA does not know who creates Indian trust records they cannot assist effectively in locating all possible trust records in NARA's possession.

**ACTIONS REQUIRED TO PRESERVE ALL INDIAN TRUST RECORDS**

The establishment of a single records center for the management and safekeeping of Indian trust records would fill the many voids itemized above as so lacking in the current program. Most importantly, a single center would provide the following benefits:

- Places the possession and preservation responsibilities for all Indian trust-related records under the control of a single management entity that identifies and incorporates the interrelationship of the various Federal and Tribal organizations, nationwide, that create the trust records and ensures the nationwide enforcement of modern, sound and standard records management and safekeeping policy, procedures and practices.

- Physically places all inactive Indian fiduciary records, regardless of origin point, in one facility that will support both government and Indian client research, reconciliation, settlement, litigation and post-audit needs. The centralized approach recognizes that certain trust records must be retained at the origination site because they are active and needed for day-to-day operations. This universe of active documents include those that currently exist on site relating to active leases, contracts and agreements and those that will be created in the future in the daily execution of fiduciary management activities (active documents). The active documents, however, would be under the management and preservation control of the Center. All other documents on site that do not meet the definition of active are inactive and will be placed in the Center.

- Provide electronic imaging capability to meet day-to-day operational, preservation, disaster recovery and research needs. The imaging of trust documents will be performed on site at the documents point of origin and at the Center depending on whether a document is active or inactive. The imaging of active documents will be performed on site to ensure the convenient availability of active documents to the fiduciary managers in carrying out their day-to-day management activities. Permanent on site imaging equipment and trained operating personnel will be available at each fiduciary management location to accommodate the imaging of the active documents. As necessary, external assistance will be provided at each location to ensure the timely elimination of active documentation imaging backlogs. Policy and procedures defining on site retention schedule of active documents and to ensure the authenticity of the related images will be implemented. The images will be housed at the Center as well as at a backup facility and will provide the needed disaster recovery and centralized research capability currently absent in the fiduciary management scheme. When records reach the conclusion of their prescribed on site retention (lease closed, contract complete, etc.) They will be become inactive and moved under strict control and preservation standards to the Center for permanent storage. Their permanent storage location within the Center will be linked to their electronic image for retrieval in legal proceedings or other uses where the imaged record is inadmissible or unacceptable. Inactive records currently on site at the fiduciary management locations and NARA record storage sites will be identified, assembled, inventoried and moved under strict control and preservation standards to the Center for cataloging, imaging and permanent physical storage. Imaging of inactive records will be performed on a priority as needed basis.

- Provide appropriate disaster recovery protection. To the extent of technological availability, records protection will begin at a document’s point of origination through the use of a modern on site imaging system that will be integrated with the resource management and accounting applications. Separation of imaged record and original source documents storage sites will be standard operating procedure to protect against loss of both forms. National Archive physical preservation and disaster recovery standards will be adopted as minimum standards by the Center.

- Maintains complete, uniform and easily accessible files of source documents.

- Economize on costs by centralizing all trust related records. All permanent record keeping functions that are now being performed at some 130 sites will be consolidated in one unit at one location. This will reduce the costs associated with specialized human resources services, records shipment, copying, records storage, training, and travel.

- Provide for the implementation of an automated records management program that will consolidate and integrate a system of indexing and imaging. This will preserve the original documents and still make the needed information, in image form, available for daily use.

**NAME AND STRUCTURE OF THE CENTER**

The proposed name of the national archives and records center will be the "National Indian Fiduciary Records Center" (NIFRC). Albuquerque, New Mexico is the proposed location of the NIFRC since it is the location of the current storage facilities for trust fund records and is the location of the Office of Trust Funds Management. The location is convenient to all records origination points and is served by all modern modes of transportation and delivery.

The organizational structure of the NIFRC supports each of the functions necessary to fully execute the United States' fiduciary records management responsibilities. The head of the NIFRC will be a fully qualified historian who will be supported by a staff of 55 fully qualified management and professional staff in the following units:

- Textual Records Division - Designs and implements inventory, storage and maintenance policy and procedures.
- Electronic Records - Designs and implements electronic records imaging methods and procedures.
- Accessions and Disposition - In charge of the physical aspects of the movement, storage and preservation of the records at the NIFRC and at functional operations levels nationwide. This included quality assurance functions and assistance to field locations.
- Special Media Laboratory - Performs restoration, conservation and maintenance of records in a deteriorated physical condition.
- Security Administration - Controls the public access to the NIFRC and prevents unauthorized entrance and removal of record materials.

The National Archives and Records Administration would be requested to provide periodic independent operational reviews of the NIFRC to ensure operational adequacy.

**WHEN MUST ACTION OCCUR**

Phase I of the Strategic Plan is designed to resolve substantially all of the trust management systems, records keeping, and accounting problems within two years or by the end of fiscal year 1999. Development and implementation of certain aspects of the overall plan will take several more years, but the objective will be for the Center to be fully operational by Fiscal Year 2000.

**WHAT WILL THE NIFRC AND IMAGING COST**

The start-up cost of the NIFRC is estimated at approximately $13.1 million which includes $2.7 million for imaging equipment and start-up costs at the NIFRC and at each fiduciary management location for on-going (steady-state) imaging and to eliminate the imaging backlog of active trust management records. The elimination of the backlog of active trust records will also require contract services of an additional $3.2 million. Ongoing costs are estimated at about $9.7 million annually.

| **Initial Costs:** | | | |
|---|---|---|---|
| Establish NIFRC | $ 9,019,917.00 | | |
| Sip Records | $ 1,071,000.00 | | |
| Boxes | $ 315,000.00 | $ 10,405,917.00 | |
| Master Electronic Archiving | $ 418,217.00 | | |
| Backup Electronic Archiving | $ 909,260.00 | | |

| | | | |
|---|---|---|---|
| Image Equip. - Backlog | $ 1,357,050.00 | | |
| Image Equip. - Steady | $ 45,700.00 | $ 2,730,227.00 | $ 13,136,144.00 |
| **Ongoing Costs:** | | | |
| NIFRC | $ 8,036,730.00 | | |
| Boxes & shipping | $ 6,750.00 | $ 8,043,480.00 | |
| MEA | $ 248,000.00 | | |
| BEA | $ 857,978.00 | | |
| Other on-site annual imaging costs | $ 502,500.00 | $ 1,608,478.00 | $ 9,651,958.00 |
| **Initial Imaging Backlog clean-up:** | | | |
| 20,000 (20% of total) high dlollar leases | $ 2,160,000.00 | | |
| 40,000 (40% of total) additional leases by field staff | $ 1,000,000.00 | $ 3,160,000.00 | $ 3,160,000.00 |

# FRACTIONATED OWNERSHIP OF INDIAN LANDS

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**Current Status**

As ownership of Indian lands descends from one generation of persons to another, fractionation continues to worsen. The Department of the Interior may soon be unable to cope with the record keeping of land titles and accurate distribution of income. In addition, if the challenge to the constitutionality of the Indian Land Consolidation Act succeeds in either of the cases Youpee v. Babbitt or Klauser v. Babbitt, the courts may order the Department to compensate individuals for the interests in trust property that escheat to Tribes.

In October 1994, the Assistant Secretary - Indian Affairs opened consultations with Tribal leaders and individual landowners concerning a legislative proposal to address the problems of fractionated heirship. Since then more than 200 meetings, attended by more than 4000 persons, have been held on or near Indian reservations by the Bureau of Indian Affairs, and, in some cases, by Tribal governments, to discuss the proposal and to make additional recommendations and suggestions for alternatives.

TRIBAL IMPACT: Tribal governments will benefit by DOI’s program. However, Tribal leaders appear hesitant to favor the Tribal government's interests over those of individual members who own allotted lands.

FUNDING IMPACT: $300 million

Draft legislation is presently being considered by the Department of the Interior to amend the "Indian Land Consolidation Act"

(25 U.S.C. 2201 et seg.) to address the Indian heirship problem. The legislative proposal package includes initiatives to consolidate highly fractionated interests (two percent or less of ownership) in allotted Indian land and a land acquisition program with provisions to transfer the properties to the Tribes, but retain the income from those properties until the purchase price paid by the Federal Government is repaid or 20 years, whichever occurs first. In order to prevent further fractionation, the legislative proposal limits inheritance in allotments to members of Federally recognized Tribes, and further limits inheritance by intestate succession to first and second degree relatives with provisions for life-estates for non-member spouses. Testate succession in trust is limited to one devisee who also must be a member of a Federally recognized Tribe; if the devise is to more than one person, joint tenancy with right of survivorship will be presumed.

DOI’s legislative proposal differs significantly from two alternate proposals drafted by Indian land consolidation groups. The Indian groups take a different approach by providing individual allottees with an equal opportunity with the Tribes to participate in the acquisition program and by taking a different approach to the inheritance limitations. All legislative proposals, however, have shared the objectives of consolidation of fractional interests and the prevention of further fractionation.

**BACKGROUND**

"The Indian Service is compelled to be a real-estate agent in behalf of the living allottees; and in behalf of the more numerous heirs of deceased allottees. As such real estate agent, selling and renting the hundreds of thousands of parcels of land and fragmented equities of parcels, and disbursing the rentals (sometimes to more than a hundred heirs of one parcel, and again to an individual heir with an equity in a hundred parcels), the Indian Service is forced to expend millions of dollars a year. The expenditure does not and cannot save the land, or conserve the capital accruing from the land sales or from rentals. . . . For the Indians the situation is necessarily one of frustration, of impotent discontent. They are forced into the status of a landlord class, yet it is impossible for them to control their own estates; and the estates are insufficient to yield a decent living, and the yield diminishes year by year and finally stops altogether. . . . The Indian Bureau's costs must rise, as the allotted lands pass to the heirship class. The multiplication of individual paternalistic actions by the Indian Service must grow. Such has been the record, and such it will be unless the government, in impatience or despair, shall summarily retreat from a hopeless situation, abandoning the victims of its allotment system. The alternative will be to apply a constructive remedy as proposed by the present Bill."

John Collier
Commissioner of Indian Affairs
February 19, 1934

**OVERVIEW**

The fractionated ownership of Indian lands is taxing the ability of the government to administer and maintain records on Indian lands. These "allotted" or individually-owned trust lands comprise approximately 11 million acres and, in size, exceed that of the States of Massachusetts, Connecticut and Rhode Island, put together. Fractionated heirship also threatens the integrity and viability of the Department's trust management systems. The problem cannot be addressed by the Tribes; it cannot be fully addressed by the Department of the Interior; it requires a Federal legislative solution.

In 1887 Congress enacted the, General Allotment Act. This Act directed the division of Tribal lands and "allotment" of them to individual Indians. The purpose was to accelerate the civilization of the Indians by making them private landowners, successful farmers, and ultimately to assimilate them into society at large. Many Indians sold their land, but few assimilated into the surrounding non-Indian communities. By the 1930's it was widely accepted the General Allotment Act (GAA) had, for the most part, failed. In 1934 Congress, in Section 1 of the Indian Reorganization Act, stopped the further allotment of Tribal lands. A direct result of the GAA was the loss of over 100, 000, 000 acres of land from the Indian trust land base between 1887 and 1934. An indirect result was fractionated heirship.

As originally envisioned, allotments would be held in trust by the United States for their Indian owners no more than 25 years. At the end of the 25 years, the land would be conveyed in fee simple to its Indian owners. Many allottees died during the 25 year trust period. In addition, it quickly became evident the allottees were not assimilating and continued to need Federal protection.

As a consequence, Congress enacted limited probate laws and authorized the President to extend the trust period for those individuals who were not competent to manage their lands. The presumption was, however, that at some point in the foreseeable future the lands would be conveyed to their Indian owners free of Federal restrictions. As a consequence, Congress did not amend the probate laws even though it continued to extend the period of trust protection. Under the Indian probate laws as individuals died, their property descended to their heirs as undivided "fractional" interests in the allotment (tenancy in common). In other words, if an Indian owning a 160 acre allotment died and had four heirs, the heirs did not inherit 40 acres each. Rather, they each inherited a 1/4th interest in the entire 160 acre allotment. As the years passed, fractionation has expanded geometrically to the point where there are hundreds of thousands of tiny fractional interests.

The Department of the Interior is charged by statute with maintaining Federal Indian land records on these hundreds of thousands of fractional interests and with probating the estates of every Indian individual who owns a fractional interest in an allotment. In many cases, the fractions are so small that the cost of administering the fractional interests far exceeds both their value plus any income derived therefrom.

In 1984, Congress attempted to address the fractionation problem with passage of the Indian Land Consolidation Act. The ILCA authorized the buying, selling and trading of fractional interests but most importantly it provided for the escheat to the Tribes of interests of less than two percent. Although over 55,000 of the 2%-or-less fractional interests have escheated since passage of the ILCA in 1984, the problem of fractionation continues to worsen. The costs of maintaining heirship records and administering the land is inordinately expensive for the BIA. Approximately 50 - 75% ($33 million) of the BIA's realty budget goes to administering these fractional interests and is, thus, unavailable for investment in productive lands. Other programs are, likewise, adversely impacted, e.g., trust funds management, forestry, range, transportation, social services, etc. Utilization and/or conveyance of the fractionated property by the numerous owners is also difficult because of the need to secure the numerous consents which are required.

Currently, calculation of fractionated lease ownerships may result in a fractional denominator that exceeds 26 digits. Depending upon the amount of lease income to be distributed, it is possible that trust income may have to be collected for several years before sufficient income is collected to entitle an account holder to even one cent.

Some administrative complications that result from fractionated ownerships include the following.

- Detailed accounting records must be maintained for all transactions regardless of size, sometimes as little as $0.03 may be distributed among seven account holders, complicating the accounting.
- In most cases, OTFM policy does not permit funds to be disbursed to the account holders until balances reach $15, thus increasing the number of IIM accounts that require interest posting and other account maintenance activities.
- Funds sometimes remain in special deposit (suspense) accounts for long periods, according to OTFM, pending OTFM's receipt of ownership information from OTR's Land Title and Records program staff and realty staff.

Currently, OTR maintains official Federal Indian land title and beneficial (lease) ownership information. OTR's Land Title and Records program staff are responsible for determining ownership and encumbrance for each Federal Indian tract of land and for certifying for the Federal Government that such ownership and encumbrance is accurate for all legal, title, and evidentiary purposes. However, due to continuing increases in fractionation, inadequate staffing, and inadequate systems, OTR has almost a two-year backlog in land title and lease ownership determinations and record keeping.

Each time ownership changes, OTR's Land Title and Records program staff must perform time-consuming manual determination and documentation of ownership interests. This is because OTR's Land Records Information System, as designed, is not capable of performing automated chain-of-title calculations and it does not store chain-of-title or calculated ownership information. LRIS system improvements have been delayed for the past two years due to reductions-in-force and budget cuts. In addition, LRIS is not integrated with OTFM's trust fund accounting systems.

Because official ownership information may be significantly out-of-date, OTFM has relied on unofficial ownership data in BIA's Integrated Resources Management System. IRMS ownership information is periodically updated by OTR realty staff located in BIA's Agency Offices based on preliminary information that they have developed for use in probate determinations. However, unlike LRIS information, it is not verified or certified. As a result, OTFM cannot ensure that income is distributed to the proper account holder.

Inactive IIM accounts, which are defined as accounts with no transactions for 18 months, also increase the administrative burden for IIM accounts. Accounts may become inactive because they are in suspense status or because probate decisions are pending. As of

September 30, 1996, OTFM reported that there were approximately 60,823 inactive IIM accounts. According to information provided by OTFM, these are generally low balance accounts. Administrative costs associated with inactive accounts include:

- the cost of computer processing time;
- the administrative cost and responsibility of safeguarding the accounts; and
- the cost of preparing, printing, and mailing quarterly account statements.

More than 12, 000 persons, 90% of whom reported themselves as members of Federally recognized Tribes, responded in writing during 1995, included written comments explaining their disagreement with the proposal or making suggestions.

Sixty-five percent (65%) of the respondents in the survey of landowners agreed with the concepts of consolidating small fractional interests in the Tribes and preventing and slowing further fractionation. Fifty-one percent (51%) of the respondents would be willing to sell their small fractional interests. An additional group would be willing to sell if they could be assured of (1) fair market value for the sales of fractionated interests, (2) tribal acquisition of title immediately, or (3) an opportunity for financing co-owner purchase options.

**PROPOSED SOLUTION**

Any legislative proposal must have two elements: existing small fractions must be eliminated and further fractionation must be prevented or drastically slowed. The goals are to reverse the adverse effects of the GAA and promote Tribal self-determination. The existing escheat provisions of Section 207 of ILCA have been found to be unconstitutional in Youpee vs. Babbitt, 67F.3d 194 (9th Cir 1995). If the Supreme Court sustains the 9th Circuit Court of Appeals decision and Section 207 of ILCA is found unconstitutional during the pendency of the legislation, or thereafter, further amendments to the Act will be required. The essential elements of the legislation should include the following:

1. A land acquisition program that authorizes the Federal Government to purchase fractional interests from willing sellers. These interests could be transferred to individual Indians or to the Tribes without any out-of-pocket costs to the Tribes.

2. The creation of a priority for the acquisition of fractional interests of two percent-or-less.

3. Some mechanism whereby fractionated interests transferred to an Individual Indian or a Tribe will be subject to the requirement that all income derived from the interests will be paid to the Federal Government until the purchase price paid for the interests by the Federal Government has been recovered or 20 years (or a like time period), whichever occurs first.

4. Income generated from the acquired fractional interests should be put into a fund to be used for the acquisition of additional fractional interests.

5. The proposal should replace the subjective test in the ILCA used to determine whether two percent fractional interests will escheat, i.e., a rebuttable presumption of future income potential, with an objective test based on actual income produced by a fractional interest or on the appraised value of the interest.

6. In order to prevent further fractionation, inheritance of interests in allotments should be limited in some acceptable and equitable way. The proposal should authorize Tribes to change the limitations on inheritance established by the bill through enactment of Tribal probate codes, provided that the changes do not result in increased fractionation.

7. New inheritance limitations should not become effective for two years subsequent to enactment. Appropriate notice should be provided to alert owners of estate planning options.

In addition, the Special Trustee proposes that the legislation consider the following:

1. Individual American Indian co-owners and non-owners ought to have equal access with the Tribes to Federal funds used to acquire fractionated interests in realty. Purchase options should be granted to individual co-owners if authorized in a Tribal land consolidation plan. Federal loan programs to assist American Indian individuals in the purchase of fractionated interests in realty should be part of the program.

2. Indian Landowner Holding Companies should be authorized to hold fractionated interests in realty. Such companies can be used to combine fractionated shares into a single interest for ownership and administration purposes. The trustee would treat the holding company as a single owner. The holding company would administer interests, including ownership records, and distribute income based on these records.

3. Tribes should be eligible for Federal loans/funding for purposes of exercising Tribal purchase options,

4. The Tribes, rather than the Federal Government should administer as much of the program as practical, consistent with principles of self governance and self determination as well as self sufficiency.

5. The legislation should not deny certain property ownership rights to individuals by limiting their ability to purchase, sell and inherit fractionated interests. While certain restrictions may be necessary, the legislation should not substantially restrict the rights of individual American Indians.

Legislation is therefore needed which would consolidate the large number of existing fractionated interests and prevent further fractionation. This alone would remove a primary obstacle to the efficient administration of the trust management systems and provide a major catalyst for the timely resolution of most of the operational problems associated with trust management activities, including trust resource and realty management, probate, land titles and ownership records management, IIM accounting, collections, deposits, investments and disbursements, customer service and record keeping for all trust management activities.

An added benefit is the annual administrative cost savings estimated at the same $33 million mentioned above.